Consultation Response

Open letter consultation: Potential expansion of the role of ELEXON

Detailed response from ELEXON's Executive Team. For more information, please contact Mark Bygraves (0207 380 4137, mark.bygraves@elexon.co.uk) or David Osborne (0207 380 4199, david.osborne@elexon.co.uk).

Definition of Terms

For ease we set out the meaning below of some of the terms used:

Subsidiary Model

ELEXON: Current BSCCo responsible for delivering the BSC services both before and after the restructuring;

ELEXON Hold Co: New company to whom ownership of ELEXON transfers from NGET; and

ELEXON Group: Group of companies owned by ELEXON HoldCo (including ELEXON and other new business enterprises).

Contract Model

New ELEXON: New company, acting as services manager to BSCCo under a new contract;

New ELEXON HoldCo: New company which owns New ELEXON (and other business enterprises); and

BSCCo: Company responsible for procuring and managing the contract with New ELEXON.

Appendix 2 Questions

Question 1.

Do you consider that we have set the right conditions for a potential expansion of ELEXON's role?

Yes, we broadly agree with all four of your conditions which bear similarity to the 8 objectives, which we have been advocating over the last 12 months with yourselves and BSC Parties to assess the possible business models to allow an expansion of ELEXON's role. Our 8 objectives are to:

1. ensure that existing core BSC business services are maintained and that there is no dilution of BSC resources and expertise
2. enable the creation of an appropriate corporate structure for existing and new activities of the ELEXON Group that supports current and future market developments
3. ring-fence liabilities, costs and risks for current and new activities (to protect the interests of BSC Parties)
4. provide for an appropriate legal and regulatory framework
5. maintain independence
6. allow for a fair reflection of current and future stakeholder interests

© ELEXON

7. avoid any unfair competitive advantage/disadvantage
8. enable appropriate funding

In addition to the conditions that you have highlighted, we believe that consideration should be given to the following:

Services – All of the services currently undertaken by ELEXON should continue to be provided by ELEXON in the subsidiary model or by New ELEXON in the contract model. This restructuring should not be taken as an opportunity to increase or (more important) reduce the service provided. A 'thick' BSCCo, where many of the existing ELEXON functions are still carried out by BSCCo, with only some being provided by New ELEXON, will be more expensive and less efficient due to inevitable duplication of effort and resource, than a "thin" BSCCo which possesses the capability to effectively manage an outsourced contract. An operational example of such a thin "intelligent client" model is MRASCo.

Longevity of relationship - Under any model, we submit the relationship must be long term in order to provide stability and value for both industry and ELEXON. We believe the 3 year term Ofgem proposes in the contract model will introduce significant risk into the central arrangements. It will introduce more risk and cost as the reprocurement exercise will need to commence about 18 months into the contract's live operation. This is too short a period to allow the contract to bed-down and creates a costly and unnecessary distraction for New ELEXON, the BSCCo Board and BSC Parties. Assuming this occurs in 2014-15, this will be coincident with the go live of the new smart arrangements which will impact the settlement of the domestic market in that:

- BSCCo's major agent contracts currently awarded to Logica and Cognizant will expire in 2014 and 2015. They will require re-procurement (managed by New ELEXON) during the same period that New ELEXON will need to commence preparation for a tender for its role;
- a tender exercise in respect of New ELEXON's role conducted during 2014/2015 is likely to have a significant destabilising effect on the industry, and so introduce more risk as New ELEXON focuses on the re-procurement of the BSC-related contract at a time of huge industry change (e.g. go live of new smart arrangements);
- a short duration will actually increase costs as the contract price will need to include a risk premium to reflect the additional risk of a short term contract.

Costs of implementation – the costs of finalising and implementing the new structure should be taken into consideration and budgeted for and all participants encouraged to minimise these costs as they will be borne by the industry and, ultimately, the consumer. One way to achieve this is for Ofgem to set a clear deadline to demonstrate determined leadership and direct that the "as is" position should be used as the starting point for defining the scope of the BSC services.

Maintaining ELEXON's independence - this is likely to be determined by the future ownership and, more importantly, control, of ELEXON which is not covered in Ofgem's consultation document, and yet will have a significant impact on the shape, and culture of the organisation created. We believe it is essential to maintain the independence of ELEXON (i.e. New ELEXON in the contract model or ELEXON in the subsidiary model); we believe it is in the wider interests of the industry and ultimately the consumer that ELEXON remains free of domination (actual or perceived) by one or more BSC Parties. We believe that a 'Not for Distribution' group structure would ensure that ELEXON continues to be driven by what is best for industry and the consumer rather than what is in the commercial interests of shareholders. A 'Not for Distribution' group structure is common amongst charities and other sectors where members are drawn from a wide community (rather than a small pool of shareholders) and profits created within the group are invested in accordance with the group's stated aims, or used to defray overheads, rather than dividended to shareholders. In this way the group is not beholden to shareholders. We believe Ofgem needs to give clear direction on this matter, and state that one or a small number of organisations should not have control of New ELEXON or ELEXON.

Timely implementation – the agreement of and implementation of any new structure should be concluded swiftly to enable ELEXON's participation in the DCC licence award process, contain costs, and minimise the potential disruptive effect on ELEXON staff. Early decisions are essential to enable ELEXON to source new funding for growth.

Finally we make the following observations regarding two of your conditions:

- **Condition 1** – "BSC Parties should not face higher costs". We believe that some commentators have interpreted this condition to mean that the cost of BSC services should not increase from current levels. However we consider that the better interpretation is that the objective of the condition is to ensure that BSC Parties do not fund non-BSC activities, with which we agree.

  For the avoidance of doubt it should be noted that costs are likely to be incurred by BSC Parties under both models not least for the reasons Ofgem identifies of BSC Parties having to bear the costs of establishing and implementing any new arrangements (and the introduction of a profit margin in the contract model where none exists at present).

- **Condition 4** – "ELEXON's BSC role should not give it any undue advantage in the DCC competition". We agree that the adopted model should not unduly advantage an ELEXON DCC bid. However, we equally consider that the said model should not unduly disadvantage ELEXON's participation in the process. We note that we are currently at a significant competitive disadvantage, in that we are restricted from preparing for a bid in a manner that other organisations (including other central bodies) can and that, given your timescales, the effect of this undue disadvantage is likely to persist until and including the DCC bid process. This is a matter of serious concern to ELEXON and we would encourage Ofgem to take all appropriate regulatory steps to expedite the implementation process in so far as possible.

Question 2.

Do you consider a contract or a subsidiary model would better meet our conditions? Please provide reasons

We believe that either model could meet your conditions, provided that the arrangements (ring-fence in the subsidiary model and contract terms in the contract model) are clearly set out and agreed.

However, for the contract model a long duration, rather than a 3 year term as you suggest, is required. We believe a 10 year contract term would see costs lower than a short term contract and introduce less risk. This is explained in more detail in our response to Question 10. The table below highlights our views on how well each condition is met by each of the two models:

© ELEXON

Assessment of how the models meet each condition	
Condition	Assessment
1. BSC parties should not face higher costs	**We consider that both models could equally meet this condition** (as explained in response to Question 1 above we interpret this condition to be a reference to there being no cross subsidies or obligation to fund non-BSC activities). **In the subsidiary model**, we consider that satisfactory comfort for BSC Parties regarding cross subsidies would be achieved from enhanced BSC ring-fence provisions in order to meet this condition. This is explained in more detail in our response to Question 13. **In the contract model**, BSC Parties would simply pay the contract price and receive appropriate information regarding the services and meeting of the contractual performance standards. This is typical for any service contract. Similarly, profit created under the contract can be used by New ELEXON as it sees fit. BSC Parties would have no say in its use. An appropriate contract will therefore meet this condition. However, a short term contract such as the 3 year term proposed, will not meet this condition. It will actually increase costs because a 3 year term would not provide enough time to implement and reap the benefits of efficiency savings; commencement of a procurement exercise after only 18 months would introduce additional early costs; and implementation costs would have a shorter period over which to be amortised. This is explained in our response to Question 10.
2. Arrangements should not place more risk on BSC Parties	**We consider that both models could equally meet this condition.** **In the subsidiary model**, additional provisions in the enhanced ring-fence potentially including appropriate step in rights and ownership "transfer back" mechanism described above will mitigate any additional risk for BSC Parties. **In the contract model,** a legally robust contract should ensure risks are mitigated. There are risks associated with creating such a contract (greater than enhancing the ring-fence in the subsidiary model) and these are referred to in our response to Question 8. However, a contract of short duration (e.g. 3 years) would we submit increase risk for BSC Parties because a short term would be very destabilising for ELEXON and its staff, be a distraction requiring early focus on the re-procurement, and it would increase the need for New ELEXON to identify in the short term alternative revenue streams to mitigate the risk of the BSC

© ELEXON

	contract not being re-awarded to it.
3. Standards of service should be maintained	**We consider that both models could equally meet this condition.** To the extent there is a belief that the standards of service within the existing BSC need supplementing, the additional provisions could be written into a contract (contract model) or clarified in the BSC/Code Subsidiary Documents (subsidiary model). However, we consider that a contract duration of 3 years is unlikely to incentivise investment in new systems and processes and this is likely to lead to a degradation in standards of service.
4. ELEXON's role should not give it undue advantage in the DCC competition	**We consider that both models could equally meet this condition.** However, the longer the changes take to implement, the more disadvantaged ELEXON becomes. This is referred to in our response to Question 8. We are concerned that without clear leadership from Ofgem and a timetable, contract negotiations could take longer than ring-fence negotiations.

© ELEXON

Question 3.

Do you consider that the role of the BSC Panel should change in response to a change in the role of ELEXON?

No. The role of the BSC Panel is clearly defined in the BSC and we would not expect its role to change. Under the contract model, BSCCo would be the procuring entity and we would expect the BSCCo Board to be responsible for the enforcement of the contract. However, in doing so we fully expect that the BSCCo Board in accordance with the BSC will take appropriate advice from the Panel (as indeed it does in relation to BSC Agents under the present arrangements).

Question 4.

Would the current arrangements for the BSCCo Board allow it to fulfil any additional responsibilities and mitigate any risks associated with the expansion of ELEXON's role?

In the subsidiary model, the BSCCo Board would have no responsibilities associated with the expansion of the ELEXON Group of companies. The BSCCo Board would remain focused only on BSC activities including ensuring compliance with any enhanced ring-fence provisions. To do this it would rely on its auditors and express confirmation of compliance from the ELEXON Executive Team and other reporting and monitoring requirements in the enhanced ring-fence, many of which already exist in transmission and distribution licence conditions. No changes to the current arrangements for the BSCCo Board are envisaged.

In the contract model, the BSCCo Board would have no responsibilities associated with the expansion of New ELEXON's role. It would finalise and thereafter manage the contract which it entered into with New ELEXON. To do this the Board would need additional (non-ELEXON) resource to negotiate, and then manage, the new contract. This could be achieved by appointing new Non-Executive Directors or, perhaps more likely, by appointing an advisor(s) who would work directly for the BSCCo Board. Ultimately it will be for the BSCCo Board to determine its exact resource requirements, but we believe a "thin" BSCCo should be maintained, otherwise costs will escalate and the benefits of the contract model will be diluted.

However to enable a contract to be put in place, some changes to the BSC would be required. As discussed at the Ofgem workshop on 8 December, we are currently working to deliver a draft of the changes to the BSC to Ofgem.

Question 5.

Do you consider that the existing role of NGET in the BSC, in particular its ownership of the BSCCo and licence obligations, should be reconsidered and in what way?

In ELEXON's view, NGET's role, ownership and licence obligations do not require reconsideration, regardless of whichever model is adopted. We note that NGET has no visibility greater than BSC Parties (partly because disclosure is already extensive) of ELEXON's operational activities under the current arrangements, and only very limited obligations. None of these would change in its capacity as owner of ELEXON (one of which is to have in place the BSC).

Under the subsidiary model, the ownership of BSCCo would transfer from National Grid to an entirely new company (ELEXON HoldCo).

Under the contract model, the ownership of BSCCo would remain with National Grid. No changes to NGET's role would be required. We do not think it appropriate for ownership of BSCCo to be transferred away from NGET in the contract model.

Question 6.

Do you consider that the BSC Board is appropriately constituted and resourced to deliver its enhanced role, including the negotiation of contracts?

No. Some additional resource would be required to advise the Board, as explained in our response to Question 4.

We note that recently some Parties have suggested changes to the Board structure and this raises concerns over the future integrity and independence of the BSCCo. We believe that, as a minimum, the recommendations of the UK Corporate Governance Code should be adopted.

Going forward in either model, the Board's focus will be on financial and commercial matters and this should be matched in the experience of its directors. Given that they will have to more involved in contractual matters we believe that these attributes should be given primacy. The existing model has two of the directors appointed from the community of industry members of the BSC Panel which highly restricts the pool of industry candidates.

Question 7.

Do you consider that the BSCCo should be given a right of 'step in'?

Step in rights can mean several different things. We presume in this context, Ofgem means the ability for BSCCo to intervene and provide the services by taking over management of BSC Agent/service provider contracts or to appoint a third party to do so.

Under a subsidiary model, this could be a new right, introduced as part of the enhanced ring-fence (see our response to Question 13), whereby the Panel (for example) could appoint an agent to step in to provide the service. This would be appropriate for the subsidiary model as there is no ability to terminate the relationship.

Under a contract model, ELEXON considers that a step in right is unnecessary as BSCCo will have a right of termination in the event of breach by New ELEXON.

Question 8.

What are your views on the best way to overcome the implementation challenges?

The implementation challenges should not be underestimated, and the steps needed to implement either model will require careful planning. To achieve this, clear leadership is required by Ofgem with a plan and timetable and a determination to ensure Parties abide by it. We anticipate that key steps will include:

© ELEXON

Key implementation steps	
Contract model	Subsidiary model
• BSC Modification to outsource the role of service manager • Contract terms and conditions agreed • Due diligence on the transfer of assets (in addition to staff) from ELEXON to BSCCo (if any) • Pension arrangements negotiation • Lease negotiation to allow New ELEXON to occupy the offices • Establishing New ELEXON and New ELEXON HoldCo • Implementation funding agreement to cover implementation costs	• BSC Modification to clarify thsat affiliates (non subsidiaries) are not restricted to BSC activities and transfer ownership from NGET • Ring-fencing provisions agreed • Due diligence on the impact of change of control of BSCCo • Pensions arrangements negotiation • Establishing ELEXON HoldCo • Implementation funding agreement to cover implementation costs

We see the key challenges for completing these as being:

- **Time –** Timeliness is very important for both BSC Parties and Elexon. We wish to explore other opportunities such as the DCC role and the level of industry change is already very high, with BSC Parties dealing with a significant number of key consultations. We believe the starting point for documenting a subsidiary relationship or a contract relationship should be the current "as is" position in terms of services, with the existing KPIs to incentivise proper performance.
- **Cost –** the contract model would be more costly to implement. In order to keep the implementation costs to a minimum, we recommend expediting the implementation period and basing the services and KPIs on what ELEXON currently delivers.
- **Clarity of process –** We presume that the BSCCo Board would negotiate the contract with New ELEXON, with appropriate support from independent professional advisors and guidance from representatives of BSC Parties, but clarity around this process and the role of Ofgem will be critical if the implementation is to be delivered quickly and efficiently and delays avoided.
- **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.
- **Distraction –** the level of industry change is already high (e.g. smart metering, smarter markets, EMR etc), and BSC Parties face a large number of calls on their time. A short, focused period of negotiations between the BSCCo Board and ELEXON Management Team, should avoid unnecessary distraction for Parties and uncertainty for ELEXON staff. We do not believe Parties will want to repeat the whole exercise as part of a new tender exercise within a short period and therefore the duration of the contract should be longer term. For example, a

© ELEXON

3 year contact would mean the first procurement would need to take place around 2014/5 at a time of significant change with the DCC going live in 2014 and Electricity Market Reform/Green Deal implementation likely.

- **Intentions of BSC Parties –**we would not wish our growth aspirations and the associated benefits to industry and consumers of the application of our expertise, to be stifled by wider discussion of related issues outside the confines of this consultation. An early view from Ofgem on issues raised under Modification Proposal P281 this would be beneficial.

It is our view that many of these issues could be overcome if a "light" contract model was adopted, based on current services and a high level heads of terms along with a clear timetable and deadline.

It is essential to have an indication of next steps and processes; we are willing to work with Ofgem following the consultation deadline in order to define a sequence of events and priorities.

Question 9.

Do you agree with our assessment that a contract could provide a relatively straightforward way of giving BSC parties confidence that they are not being called upon to carry the costs of new activities?

Yes. Once a contract is in place, BSC Parties should have this confidence, assuming the contract is not a "cost pass through".

However, putting that contract in place may not be straight forward. It will depend on the approach taken and scope of the contract and the role and aspirations of various parties. There is a risk that a contract could become unnecessarily complex, which will be time consuming and expensive, and unnecessary given that much of the detail is already well documented in the BSC and that should form the basis of any contracted services.

Question 10.

If the contract model is adopted, do you consider it a viable option to create a contract on the basis of "as is" service levels and costs (+ margin to be negotiated) for a relatively short period with a requirement on the BSC to retender after a period of x years? If so what period do you consider appropriate?

We completely agree that a contract based on "as is" services and cost will offer the fastest and most cost efficient way to implement a contract model. We believe "as is" service levels should be the existing requirements of the BSC and those activities currently undertaken (which will need to be set out in the contract). This will include definition of activities currently undertaken which are broader than specified under the BSC (e.g. how we 'do' the change process).

We also agree that a margin (to be negotiated) on top of "as is" costs is appropriate.

However, we disagree strongly with the suggestion that the contract should be for a "relatively short duration accompanied by a requirement to re-procure". We firmly believe a short duration of 3 years as suggested by Ofgem is sub-optimal because it will:

- increase costs: a 3 year term would not provide enough time to implement and reap the benefits of efficiency savings, starting re-procurement after only 18 months introduces additional early costs, and a short duration means the initial implementation costs have a shorter period over which to be amortised.

© ELEXON

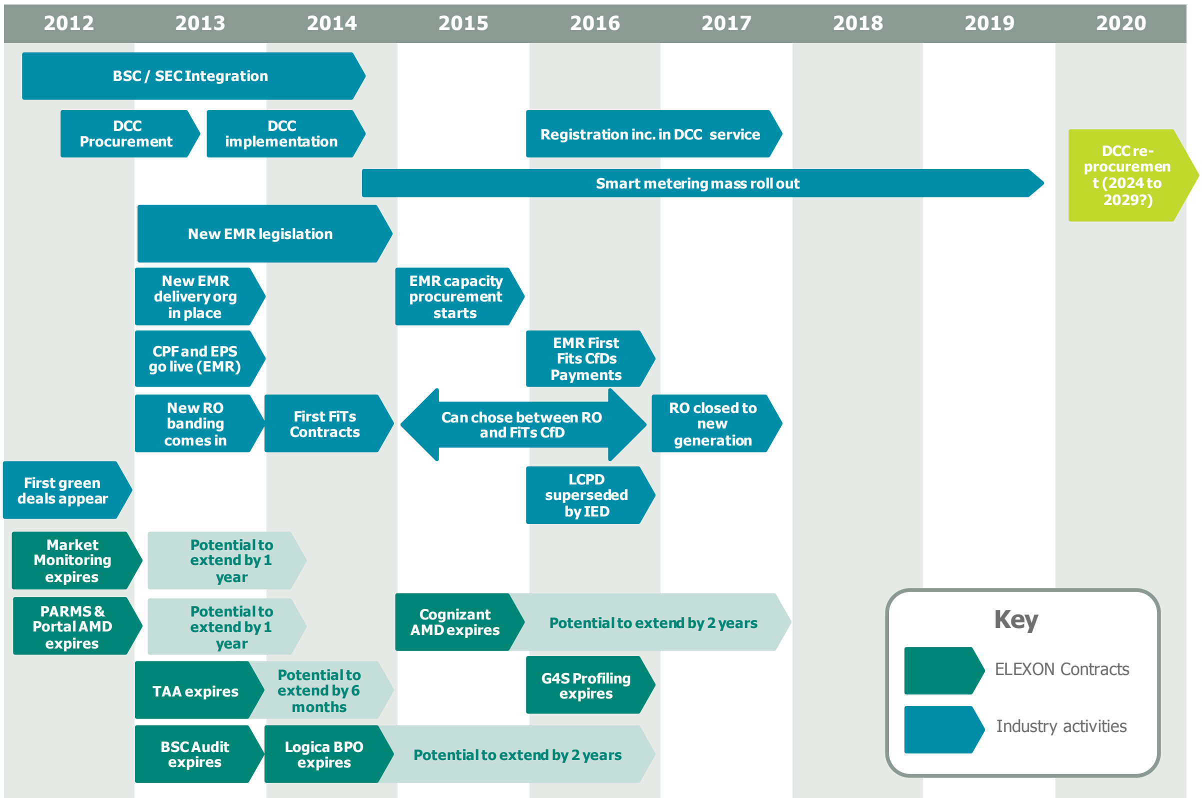
- increase risks in delivery of the BSC arrangements in that:
  - BSCCo's major agent contracts currently awarded to Logica and Cognizant will expire in 2014 and 2015. They will require re-procurement (managed by New ELEXON) during the same period that New ELEXON will need to commence preparation for a tender for its own role;
  - a short term contract would be very destabilising for ELEXON and its staff, increasing the risk of attrition of key personnel;
  - a tender exercise in respect of New ELEXON's role conducted during 2014/2015 will be an unwelcome distraction and additional risk for industry at a crucial time in the smart metering and EMR timetables;
  - it would act as an unnecessary distraction for ELEXON requiring early focus on the tender beginning in only the second year of the contract;
  - it would increase the need for New ELEXON to identify in the short term alternative revenue streams to mitigate the risk of the BSC contract not being re-awarded to it; and
  - it would lead to a risk of degradation in service standards due to a lack of investment incentives.
- not enable ELEXON to monetise the contract. ELEXON has been advised that a longer term contract will be required in order that the profit element can be monetised so providing a source of debt funding. A short term contract will mean New ELEXON will require additional equity funding which will be more expensive and/or difficult to source with a short term contract which in turn will place in jeopardy New ELEXON's strategy to apply its expertise to new activities for the benefit of industry and ultimately the consumer; those costs would be reflected back into the contract terms.
- potentially rule ELEXON out of a DCC bid as ELEXON would need to focus on retaining the BSC contract, instead of implementing the DCC services (should it be successful in winning a bid to provide those services).

We presume the perceived benefit of a tender after only 3 years is a reduction in contract price. However, as a significant proportion 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.

These and further points have been made by BSC Parties, including at the Ofgem meeting on 8 December:

- It introduces cost and operational uncertainty;
- It has a significant destabilising effect on the core operations;
- The tender will commence during a period of significant industry upheaval (Smart metering, EMR, BPO re-procurement) and so Parties will have little time to influence the re-procurement;

© ELEXON



- It provides insufficient time to identify, implement and realise efficiency gains to offset implementation costs, and so will not lead to efficiency savings;
- Insufficient time to enable the contract to "bed-down"; and
- Re-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 Ofgem would achieve by forcing a re-procurement after just 3 years.

We believe that 10 years is a more appropriate term, given the other industry developments. We note that the profit element/margin will be reflective of the duration of the contract, and so believe that this approach is likely to also offer better value for money.

We understand, through the Issue 40 group, that the provisions of services under the MRA have been provided under contract since 2002 without a competitive procurement exercise.

© ELEXON

Question 11.

If the contract model is adopted, which assets, if any, do you consider should remain with the BSCCo or be transferred to the new ELEXON?

We envisage (without limitation) the following being transferred to New ELEXON:

- all staff (who would transfer to New ELEXON by way of TUPE) along with staff related contracts and arrangements e.g. the defined contribution pension schemes; and
- the ELEXON brand and website (elexon.co.uk).

We envisage, (without limitation) the following would continue to be held by BSCCo:

- BSC Agent contracts (although they would be managed by ELEXON);
- Property lease; and
- IPR.

It should be noted that under this approach, some of the BSC Agent contracts will require amendment to reflect that New ELEXON is being authorised to manage them on behalf of BSCCo. Further, New ELEXON would require the appropriate rights (including licences) in respect of IPR, data, premises, systems, materials, etc to enable it to perform its role.

Question 12.

If the contract model is adopted, what approach do you consider most suitable for ensuring that incentives exist for performance, that service levels are sufficiently defined and secured, and that value for money achieved?

In our view, Service levels (and credits) must be seen as part of a package of contractual measures to maintain the focus on restoration of the service to the required levels and not as an end in themselves. We further consider that a balance needs to be struck between setting proportionate sanctions for poor performance and appropriate incentives reflecting improved service performance and/or cost/efficiency savings. It should be noted that an over-aggressive approach to service credits could be expected to result in a higher price to reflect higher risk premium.

We would expect the contract to contain service levels based on existing published KPIs. BSCCo already presents KPIs to the BSC Panel and industry, and we consider these to be a sufficient basis for the contract.

© ELEXON

Subsidiary Model

Question 13.

Do you consider that in the event the subsidiary model is adopted, a ring fence would provide a suitable safeguard of BSC Parties interests?

Yes. If this option were to be selected, we do think that enhanced ring-fence provisions in the BSC could provide sufficient safeguard for BSC Parties. There are already strong protections for BSC Parties in the BSC, for example:

- Section C already prevents ELEXON/BSCCo from:
  1. Disposing of IPR in systems;
  2. Applying assets, cash flow and other resources to anything other than BSC related activities;
  3. Borrowing more than £10 million without BSC Panel approval;
  4. Making any profit (the BSC already precludes ELEXON from lending money or granting credit to non-BSCCo organisations – e.g. a parent or sister company – without BSC Panel approval); and
  5. Creating security over any BSC assets without BSC Panel approval.

These provisions already create a substantial ring-fence and would continue to operate as a ring-fence ensuring that assets, cash flows and other financial resources are applied to meet the needs of the BSC Parties, and are not diverted elsewhere restricting the activities which BSCCo is permitted to carry out and restricting the disposal of and creation of security over BSCCo assets.

In addition there are a number of monitoring and reporting obligations contained in Section B of the BSC and consequently there is more disclosure of ELEXON than any other central body.

A more comprehensive package of safeguards than are currently included may be needed to satisfy BSC Parties that they are adequately protected. Ring fencing is commonplace in the regulated sector and also in project finance documents. Additional covenants and restrictions, monitoring and reporting requirements and contractual enforcement mechanisms could be introduced, which together should be fully capable of protecting BSC Parties, thus reinforcing the achievement of Ofgem's condition.

Appropriate step in rights and an ownership “transfer back” mechanism could be inserted in the BSC to provide remedies in the event of material breach of the ring-fence provisions. Clearly it would not be appropriate for BSCCo to accept any level of financial risk without having the upside of a profit stream. However if the BSC Parties feel that a financial incentive is necessary one possibility would be to modify the cost recovery model to provide a similar profit element to that envisaged for the Contract Model.

Specifically, what are your views on:

Question 13A.

The BSC Panel’s ability to effectively hold ELEXON to account under the subsidiary model?

In our view, the BSC already gives the BSC Panel the necessary powers to effectively hold ELEXON to account directly through its Panel role and indirectly via the ELEXON Board which has BSC Panel industry members. Given that the subsidiary model leaves the role of the Panel unchanged, we do not see this position changing.

© ELEXON

In the absence of a profit margin being introduced in the subsidiary model for ELEXON, it would not be appropriate for there to be an ability to impose financial sanctions on ELEXON under the subsidiary model. However, there are other ways for the Panel to hold ELEXON to account, for example through step-in rights, or by transferring ownership back to NGET as explained above.

It is worth noting that under the contract model it will be the BSCCo Board and not the Panel that holds New ELEXON to account under the service contract (although some of the Board are appointed so the Panel does have influence).

Question 13B.

Whether enhancing NGET's licence to put new responsibilities on them in respect of any ring fence provision would be a suitable approach?

ELEXON believes that it is for NGET, Ofgem and BSC Parties to agree what, if any, additional responsibilities should be placed on NGET and the most appropriate method for doing so.

Question 13C.

Whether it would be better to do this through a new licence which would make Ofgem responsible for enforcement?

We understand that the creation of a new licence would require primary legislation, which would be complex and time consuming.

If the provisions in the BSC relating to the ring-fence, including enhanced rights such as step in and transfer back, are properly crafted thenin our view it will not be necessary for a new licence to be introduced. This is because a licence will be, by necessity, high level and cross-refer to the BSC. Financial sanctions could be introduced in the licence but this would require a profit to be introduced for ELEXON in return. The ultimate sanction of revocation would, in effect, be replicated by the suggested "transfer back" ring-fence provision (see our response to Question 13).

Therefore a licence brings no obvious benefits to industry, given that there are existing ring-fence arrangements which could be further enhanced by additional provisions. In addition, we note that Ofgem already has the ability to take action against poor performance by ELEXON through its appointment of the Chairman and its influence and responsibilities over market arrangements.

© ELEXON

Main Document – Contract Model Consultation, page 8 – Costs
Question 14. **Do you agree with our view that start up costs themselves do not provide a sufficient basis for determining the appropriate model?**
Yes we agree in principle. However, the overall costs and benefits of each model over the life of the contract should be evaluated. The longer the contracted term, the lower the risk premium and the more likely it is for benefits to exceed costs. As a significant proportion 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. Costs under a contract model will be higher than a subsidiary model as negotiating contract terms is more complex than ring-fence provisions, making more extensive use of internal and external resources and, going forward, BSCCo Board will require additional resource to manage the contract, plus the contract margin. Implementation costs must be carefully managed to ensure that they are minimised wherever possible. This could be achieved through the implementation of a light contract based on "as is" services and a high level heads of terms, with a clear timetable.
Question 15. **Do you consider that the benefits of the contract model would likely outweigh the additional cost of a premium?**
We assume that by "cost of a premium", Ofgem means profit margin. It is impossible to judge whether the benefits of the contract model will outweigh the cost of a premium at this stage, when the cost of the premium is unknown and the benefits to be gained have not been quantified. However, we do believe that the likelihood of the benefits outweighing the costs increases with the length of the contract.
Main Document Contract Model Consultation, page 9 – Risk
Question 16. **What resources/support would the BSC board need to negotiate the contract?**
The Board will require independent external legal advice, and commercial resource to advise it on, and assist in the negotiation of the terms of the contract. The level of resource needed will be dependent on the level of detail in the contract, the number/type of service levels, and how much of the service is based on existing services and KPIs. We note that BSCCo may also need some enduring contract management resource to manage the contract with New ELEXON. We believe that it will be critical to keep this enduring resource to a minimum in order to maximise the benefits of the contract model. For example an undesirable scenario would be for a high percentage of ELEXON staff to stay with BSCCo (a "thick" BSCCo), as this would result in little material change from the current model, at significant additional cost (implementation costs and margin).

© ELEXON

Question 17.

Do you consider that core assets and functionality should remain with the BSCCo or be transferred to the new ELEXON?

See our response to Question 11.

Question 18.

What are your views on which assets and functionality should be retained?

See our response to Question 11.

Question 19.

Do you consider that the BSCCo should be given a right of 'step in'?

See our response to Question 7.

Main Document Contract Model Consultation, page 9 – Service Levels

Question 20.

Do you consider this approach to be suitable for ensuring that incentives exist for performance and that service levels are sufficiently defined and secured in any contract?

See our response to Question 12.

Main Document Contract Model Consultation, page 10 – Implementation

Question 21.

We invite views on our assessment of the implementation challenge and particularly on whether the success of this model relies on ELEXON securing a business partner.

A summary of our views on the key implementation challenges is included in our answer to Question 8. In relation to some specific points on page 9 and 10 of the consultation document we would respond as follows:

1. **Appropriateness of using Section E as the implementation vehicle** - in principle we believe that the New ELEXON role (which will effectively be a "managing agent" for BSC Agents) could also be deemed to be a BSC Agent but we believe that its special purpose of, in effect, performing the BSCCo role means that it should be treated differently from other BSC Agents in certain limited respects. For instance, a BSC Agent should not be allowed to also perform the New ELEXON role because they would then be managing themselves and cease to be independent. In addition, the role of New ELEXON should not be split up into its constituent parts, allowing the BSCCo Board to in-source some elements (leading to a "thick" BSCCo) as this would duplicate costs and be highly inefficient.
2. **TUPE** – TUPE regulations are designed to protect staff who transfer to a new employer, by ensuring their existing terms and conditions are unaffected. As such, we do not believe that this is an impediment to change. However, as with any change, the destabilising effect of uncertainty cannot be underestimated. We therefore argue that decisions which affect our staff are communicated as early as possible, recognising that

© ELEXON

many will be unfamiliar with TUPE and the protections it provides. We expect all BSCCo personnel (except BSCCo Board directors) to transfer employment automatically by operation of law to the entity providing the service (i.e. New ELEXON), and not to the new holding company as suggested in Ofgem's consultation.

3. **OJEU/procurement** – we note that Ofgem's advice is that a tender following the OJEU process would not be required to put in place a service contract between BSCCo and New ELEXON. We believe that a tender following the OJEU process would have had a significant impact on implementation timescales and cost.

4. **Viability of the contract model if New ELEXON cannot attract investment** – we feel that attracting new investment for new activities is New ELEXON's issue to resolve in conjunction with New ELEXON HoldCo, and we don't believe that a lack of investment would hinder the provision of the BSC service under a contract.

Main Document – Subsidiary Model Questions, page 11 - Costs

Question 22.

We welcome your views on what, if any, changes to current ELEXON reporting arrangements would be required to provide BSC parties with the appropriate level of assurance that they are not funding non-BSC activities.

We don't envisage significant change, as ELEXON is already highly transparent in its financial and KPI reporting (in fact more so than any other central body). We envisage that the ELEXON Executive Team would be required to confirm to the BSCCo Board that use of the BSC assets was in compliance with the enhanced ring-fence.

Main Document – Subsidiary Model Questions, page 12 - Risks

Question 23.

We welcome views on these issues and on the merits and enforceability of a ring fence of the BSCCo generally.

See our response to Question 13.

Question 24.

The BSC is not captured under special administration arrangements such as those which exist to mitigate the risk of failure of a network licensee. We invite views on this issue.

Assuming that robust ring-fencing is in place (as described above) we can't envisage any significant change in the risks compared to the existing model, to which special administration would be a mitigant.

Special administration is usually used to prevent creditors from realising the value of assets by selling those assets and effectively ceasing to provide the service. However, the business of the BSC has few assets and the value thereof is low when compared to the value that a creditor can receive by continuing to provide the service. There is therefore little risk from this type of creditor action and hence special administration requirements are not needed in our view.

This response applies equally to subsidiary and contract models.

Main Document – Subsidiary Model Questions, page 12 - Service Levels

Question 25.

We consider that it would be relatively simple to codify the existing standards of service and to include them in the BSC itself. We invite views on our assessment of this issue.

We don't believe that this is necessary; key standards applying to BSCCo are already codified, and they are set out in the BSC and Code Subsidiary Documents.

The Code Administrators' Code of Practice also sets expectations in terms of the services required by BSC Parties of BSCCo when progressing changes.

Main Document – Subsidiary Model Questions, page 12 - Competition

Question 26.

There is a need to ensure that fixed costs are allocated fairly so that the BSC contract does not unfairly advantage ELEXON and the need to make BSC resources (particularly IPR) available to other parties on equivalent terms. We invite views on our assessment of this issue.

In the contract model, New ELEXON will require the right to access and use these assets for BSC services.

In the subsidiary model, the ring-fence as previously described will ensure BSC assets are not being used for non BSC activities.

Use of BSC assets for non BSC activities under both models will require separate arrangements agreed on arm's length terms. It would be the responsibility of BSCCo (or BSC Parties) to agree these arrangements on a case by case basis.

Main Document – Subsidiary Model Questions, page 13 - Implementation

Question 27.

We consider that the subsidiary model may require a considerable amount of modification to the BSC, and perhaps the transmission licence. We invite views on our assessment of the implementation challenge.

We believe that the requisite BSC drafting is minimal and do not believe that the subsidiary model would need significantly more legal drafting than the contract model. The difference is not so much in the quantity of text but whether the drafted text is included in a contract or within the BSC itself.

For a summary of the implementation drafting required for each model, please see our response to Question 8.

As stated previously, we do not envisage that a licence change is required for either model.

© ELEXON