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The future ownership of Elexon

Thank you for the opportunity to respond to your consultation seeking views on the future ownership of Elexon. I am pleased to share the Electricity System Operator's (ESO) response.

Who we are

As the ESO for Great Britain, we are in a privileged position at the heart of the energy system, balancing electricity supply and demand second-by-second. We keep the lights on and the electricity flowing directly to where it's needed across society. But that's not all we do.

As the UK moves towards its 2050 net zero target, the ESO has a vital part to play. We want to operate a zero-carbon electricity system by 2025 so we're collaborating with global industry experts to facilitate a low carbon energy future. We play a central role within the energy industry, looking at what the future may bring and how the market needs to adapt to deliver a greener future. We are facilitating the journey to net zero by collaborating with others, sharing insights and analysis, and running world-first innovation projects.

ESO as the current owner of Elexon

As noted in the consultation, Elexon is currently a wholly-owned but operationally independent subsidiary of the ESO. It is governed by its own Board and by the Balancing and Settlement Code (BSC) Panel, made up of industry, consumer representatives and independent experts.

The creation of a Future System Operator

On 6 April 2022, BEIS and Ofgem published their decision on the Energy Future System Operator consultation, the culmination of a number of years of strategic thinking and industry engagement on how best to support the energy transition. The decision confirmed the creation of a new, independent Future System Operator (FSO) founded on the existing roles and capabilities of the ESO. This organisation will drive progress towards net zero, deliver value for consumers and support energy security. As well as the existing roles of the ESO, the FSO will assume responsibility for new and enhanced industry roles crucial to the transition to net zero. We recognise that the creation of the FSO drives the need to consider the future ownership of Elexon, but that no changes are proposed to its roles, operations or governance.

A summary of our response

We are broadly supportive of the preferred proposal set out in the consultation for enduring industry ownership as the model that best preserves Elexon's independence and accountability to industry. However, we recognise that this is dependent on the future ownership parties being fully supportive of the process. We do not have strong views on which parties would be best suited to take on the shareholder role, although the chosen group must remain viable in the long-term as the composition of BSC parties continues to change.

While we understand why a temporary fallback option has been proposed, we would like to further understand how it would work in practice and the proposed exit arrangements regarding process and timelines. We also believe that other fallback options such as temporary ownership by another public organisation should be explored. Our strong preference would be to work collaboratively and at pace to ensure such a fallback option was not required, given that it has the potential to introduce further complexity and could prolong the sense of uncertainty for Elexon and FSO employees.

As noted in the consultation, we agree that any decision taken on ownership should enable Elexon to continue to perform its existing important functions and should not preclude any outcomes of the Energy Code Reform work. Consideration should be given to how the timescales associated with the future appointment process as administered by Ofgem, as well as the licensing requirements, will interact with the ownership transition to minimise the potential for complications.

It is also crucial that in the transition to a new ownership model, the needs of Elexon's employees remain paramount. To ensure Elexon can retain, attract and develop the talent it needs to continue to fulfil its critical roles, the approach to transition should minimise uncertainty in both timelines and outcomes, giving timely assurances on the organisational model along with impacts for individuals around issues such as pay, location, terms and conditions, and job security.

We look forward to working with Elexon, BEIS, Ofgem and other industry parties on the implementation of a new ownership model following the outcome of this consultation. If you have any questions regarding our response, please direct them to Colm Murphy (colm.murphy@nationalgrideso.com) in the first instance.

Yours sincerely,

Kayte O'Neill
Director of Transformation, Electricity System Operator

Our response

1. Do you agree with the proposed criteria to determine the future ownership of Elexon?
Please state why.

We agree with the proposed criteria to determine Elexon's future ownership. Elexon plays an important role in the administration of the BSC, Market-wide Half-Hourly Settlement (**MHHS**) and Electricity Market Reform (**EMR**). It is crucial that the ability of Elexon to continue to deliver these roles is protected during the transition, and that the delivery of the Future System Operator is not compromised. Similarly, we see the independence and resilience of the organisation as key to its future success.

We would add that as part of the proposed criteria, the needs of Elexon's employees should be paramount. We know from engaging with our people on the creation of the FSO that uncertainty can be concerning. To deliver key industry work, Elexon will need to retain, attract and develop talented employees, and so the approach to the transition should minimise uncertainty in both timelines and outcomes, giving timely assurances on the organisational model along with impacts for individuals around issues such as pay, terms and conditions, job security etc.

2. Do you agree that public ownership and industry ownership are the two most credible ownership options? In your view, are there any other ownership options that we should consider, and why?

We agree that the two ownership models outlined in the consultation are the most credible options currently to preserve the independence of the organisation.

3. Do you agree with our stated preference of the potential combinations of BSC parties which could own Elexon if industry ownership were chosen? Please state why.

We do not currently have a particular preference for any potential combination of BSC parties to own Elexon. We recognise that a smaller pool of BSC parties may better enable to the transition to move at pace. However, we note that the industry ownership model must be viable in the long-term as the composition of BSC parties continues to change. We would note that we anticipate the FSO will remain (or need to become, depending on the organisation's legal form) a BSC party.

4. To what extent do you agree with the above analysis of the two main ownership options, public ownership and industry ownership, and our preference for industry ownership?

We agree that there are no significant advantages of either ownership option when considered against the proposed criteria. Without a specific case for public ownership, we agree that a sensible enduring option is industry ownership. However, we recognise that this is dependent on the future ownership parties being fully supportive of the process.

We would note that the needs of employees should be captured and taken into account wherever possible to ensure talent retention, with clear communication of key milestones and any employee implications as early as possible.

5. To what extent do you agree with our proposal that Elexon should transfer temporarily into the public sector as a subsidiary of the FSO as a last resort, if industry ownership was chosen following consultation but could not be implemented without delaying the creation of the FSO? Please explain why.

We broadly support the principle of a temporary fall back option for Elexon ownership to ensure FSO implementation is not delayed. However, we would like to better understand how the proposed option (Elexon becoming a subsidiary of the FSO) might work in practice. We also believe that other fallback options such as temporary ownership by another public organisation should be explored.

For temporary ownership by the FSO, we believe a number of details would need to be worked through to consider how quickly such an option could be implemented, whether it would significantly reduce delay of FSO implementation and establish a clear process and timeline for how the model would come to an end. Some detailed questions that would need to be considered might include whether Elexon would become subject to any corporate governance arrangements agreed between the FSO and its shareholder, or would require separate provisions, and which rules and processes generally applicable to public corporations might apply to Elexon during the temporary transition phase

Given the potential complexities outlined above, we believe other fallback options (likely to be temporary public ownership of some form) should also be explored at this stage. However our strong preference would be to work collaboratively and at pace to ensure that any fallback option was not required, given that it has the potential to introduce further complexity and could prolong the sense of uncertainty for Elexon and FSO employees.

6. Are any other changes required to implement either of the two ownership options?

There are various implementation issues that we believe would need to be considered, including:

- **Pensions** - Elexon is currently part of the Electricity Supply Pension Scheme (ESPS). Further work would be needed to make arrangements for the transfer or set up of an alternative pension scheme.
- **Mechanism for recovering Value Added Tax** - Disposal of shares in Elexon are considered an exempt financial supply which means under VAT legislation the VAT on costs associated with the sales is irrecoverable from HM Customs and Excise.
- **Interaction with Energy Code Reform** - the licensing of Code Managers as proposed under the Energy Code Reform work may need to be coordinated with the timescales associated with a change in Elexon ownership, particularly in the event that transitional arrangements are necessary.

7. What are your views on the proposed licence and code changes set out above?

While we agree with a number of the proposed licence and code changes set out, we have some further comments:

Changes to licences

Under the implementation of the industry ownership model, it is proposed that the obligation to establish the BSC Company (**BSCCo**) (in Paragraph 1B of Condition 3 of the Transmission Licence) should be removed. While we agree that this would be an appropriate

change, we suggest that it would make sense to remove this under either the public or industry ownership option.

For either ownership option, it is proposed that the remainder of Condition 3 of the Transmission Licence should pass to the FSO's Electricity System Operator licence. We request that further consideration is given to this issue. The requirements imposed on the ESO, which include to have in force a BSC and secure certain details of what the BSC will and won't contain, were introduced at a time when the ESO's relationship with the BSC was quite different to today. This relationship would change even more fundamentally with a move to an industry ownership option. We question whether it remains appropriate for the ESO (or, in the future, FSO) to retain the level of overall responsibility for the BSC in licence conditions, given the role it will have. We would welcome further discussion with BEIS and Ofgem on this issue.

Under the industry ownership option, we agree that it would be appropriate to add into the licence(s) of the proposed new shareholders an obligation to own the BSCCo and to co-operate in its maintenance as necessary.

Changes to codes

Aligned with the view expressed in the consultation, we do not consider that ownership under the public option (whether as a permanent or fall-back solution) will itself require substantive changes to Section C or the BSC more generally, apart from a change in references to the new FSO.

Under the industry ownership option, we agree that Section C of the BSC would need to be amended to reflect the existence of multiple shareholders. This would necessitate changing references from National Electricity Transmission System Operator (NETSO) in Section C to the new shareholding group, while also considering the substantive provisions required to accommodate the new ownership arrangement, such as removing the prohibitions on increasing BSCCo's share capital or transferring issued shares, both in paragraph 2.2, Section C, BSC. In particular, we believe that the majority of revisions to the BSC resulting from a change to industry ownership would arise in paragraphs 2.2-2.7, Section C.

However, we do not believe that it would be correct to remove all references to NETSO in Section C and we request that a more detailed review of this is carried out (which we would be happy to assist with). In particular, some references relate not (or not solely) to the ESO's role as shareholder but also its role as the entity which is subject to Condition 3. If (noting our request for further consideration of this above) the FSO remains subject to any part of Condition 3, these references in Part C should remain too. For example, paragraphs 3.7 and 3.8 are relevant here. In addition, we believe that paragraph 2.6 should continue to apply. This would be necessary to require Elexon and its subsidiaries to take steps to ensure that the FSO is able to comply with the licence condition.

There are other areas of the BSC that we believe merit further consideration for change, on the basis that they refer to the ESO in its capacity as shareholder of Elexon. For example, Paragraph 4.4.1, Section H, BSC notes that "The NETSO (in each of its capacities under the Code) shall ensure that Protected Information is not [...]". This may include information that the ESO receives in its role as shareholder, or otherwise.

We expect that changes to the BSC will need to clarify which provisions will continue to apply to the FSO (i.e., in its capacity as System Operator and a Voting Party under the Code), and which will be appropriately attributed to the new shareholders of Elexon.

8. Have we considered all relevant costs and benefits of these proposals? Please state why.

Based on our current understanding, we agree with the costs of implementation that have been identified and that they are likely to be minor. We would appreciate assurance that any

costs associated with the sale of shares (e.g. transaction costs, and associated VAT costs as noted in question 6), as well as any other costs efficiently incurred by the ESO in supporting the transition to a new ownership model, would be recoverable.