

Balancing & Settlement Code Panel

By email: futuresystemoperator@beis.gov.uk and SOreview@ofgem.gov.uk

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Dear Ofgem and BEIS,

Consultation on the Future Ownership of Elexon

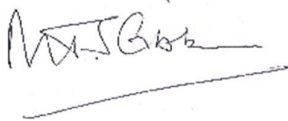
We write on behalf of the Balancing and Settlement Code Panel in response to the consultation on the ownership of Elexon.

The BSC Panel has a very close relationship with the Elexon organisation, but a quite distinct governance, and therefore a separate perspective on the issues that creating the FSO brings for Elexon.

Our responses to each question in the consultation are attached. The current ownership arrangements have worked well for many reasons despite their unusual structure, and much of the Panel's thinking is about how to preserve the positive aspects of them while recognising the importance of supporting the transition to the FSO.

We make them in a constructive spirit and would be very happy to discuss them further if you wish.

Yours sincerely



Michael Gibbons CBE, FEI
BSC Panel Chair



Dr. Phil Hare
BSC Panel Deputy Chair

FUTURE OWNERSHIP OF ELEXON RESPONSE TO INDIVIDUAL CONSULTATION QUESTIONS

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

The Panel agrees with the proposed criteria.

However, we suggest that the ambition of “minimising” disruption in Criterion 1 is strengthened: the current economic pressures on the GB electricity system are likely to put even more stresses on the Code and its efficient working may be vital to keeping the market functioning. Equally the MHHS programme must not be undermined at this delicate stage. MHHS is one of the most ambitious transformative programmes the electricity system has ever undertaken, affecting nearly all players. The benefits are some of the largest envisaged in such a transformation. With Elexon playing a central role to its programme management it is very important that this position is not destabilised in any way.

In ensuring “resilience to future change” a Panel member suggested that this criterion was reworded so that the immediate needs were recognised, but the longer-term issues could be embraced.

2. Do you agree that public ownership and industry ownership are the two most credible ownership options?

The great majority of the Panel agrees that Public ownership and industry ownership are the most credible ownership options.

Elexon’s private ownership has enabled it to operate highly effectively in a fast-changing business environment. It has consistently achieved very high rankings in customer surveys of the Code Administrators.

In considering the industry option, we also thought that some Parties may have concerns about having a shareholding without any normal controls a shareholder would expect. A Panel member suggested that there may be merit in exploring more nuanced alternatives, for example in which a Board of Trustees manages the private ownership, to mitigate the concerns that in some way liabilities may fall on the shareholders (in the longer term).

Another Panel member noted that shareholder organisations have a history of creating more value, supporting the view that industry ownership was preferable.

The Panel suggested that Elexon’s pension liabilities were quantified as even if there were putative arrangements to deal with them, any new owners would, at least, wish to understand them.

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

The great majority of Panel members saw all three of the options as viable.

On balance, the Panel has a moderate preference for the Licensed Funding Parties option on the basis of minimising the effort, the number of Parties affected and the ability to direct so that timescales can be met. However, we also suggest that transfer of the Elexon shareholding to NGET could be a very pragmatic alternative which also keeps Elexon in private ownership (discussed further below).

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One Panel member had a preference for all Parties to have ownership of Elexon by making this a condition of the Code. They recognised that this may require more lead time, but that would avoid any question of discrimination. Furthermore, it would avoid any additional licence conditions, which they felt was highly desirable.

A few Panel members were concerned that some Parties have debt covenant or other company restrictions that currently would prohibit an ownership of a regulated entity (as proposed for Elexon in the Code Governance Reform). This may not be a barrier in the longer term as companies can adapt, but it may result in objections that hold up the FSO transition.

Another Panel member suggested that it may be sensible to keep open the option of increasing the ownership community from an initial few to a wider grouping as the organisation and conditions evolve. We note that the REC has adopted an evolutionary approach to its ownership, albeit in the opposite direction.

Some Members expressed concerns that the removal of Panels and introduction of Stakeholder Advisory Forums that will happen under Code Governance Reform will eventually lead to most unusual governance structures that could ultimately lead to Parties being exposed to liabilities over which they had no control.

While recognising the way in which the current arrangements effectively pass all Elexon costs to funding Parties rather than shareholders (including potential penalties, pension fund obligations etc) and the intention to continue such protection, another Panel member expressed concerns that Parties could end up having a shareholding over which they had no control whatsoever.

As the current shareholder structure has worked very well for several reasons, and Elexon has been owned by NGET in the past, the Panel considers returning the shareholding to it has various merits:

- *it keeps Elexon in the private sector;*
- *the Balancing and Settlement Code (Section C 2.2.3¹) already provides for such direction by the Authority and therefore suited to the short timescales envisaged;*
- *any concerns about Pension fund liabilities would not be relevant;*
- *it avoids any other complications and potential objections from Parties taking shares in Elexon; and,*
- *it represents minimal change to the current arrangements*

The Panel also considered the DNOs (collectively) may also be a suitable group of private shareholders which met many of the criteria that led to it suggesting NGET as an alternative. However, potential delays and complications dealing with several organisations that make this option less suited to the short timescales needed to get the FSO launched on time. The Panel could also see some remote potential conflicts arising from the interactions between the BSC and the DNOs in the future. National Grid's ownership of Western Power Distribution raises the potential for the same conflicts, but one step removed, and the Panel was confident they were minimal.

¹ 2.2.3 If directed to do so by the Authority, the NETSO shall execute and deliver a transfer of the shares of BSCCo to such person as the Authority considers appropriate to succeed to the NETSO in the capacity of BSCCo Shareholder for the purposes of the Code, upon payment by or on behalf of such person of an amount equal to the par value of such share or shares; and upon such transfer taking effect the NETSO shall be released from all future obligations as BSCCo Shareholder

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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?

A strong majority of Panel members expressed a preference for industry ownership because it better enables Elexon to act in its business environment now and in its role anticipated in the Code Governance Reform. The main reasons for this were being able to:

- retain and attract the people it needs to carry out its role in a highly competitive labour market - Elexon has a highly skilled workforce that have experience highly desired by industry and other Code Bodies and any constraints from public sector ownership would inevitably be detrimental;*
- procure the services it needs in a fast and flexible fashion because, were it to be in the public sector, Elexon will almost certainly be required to adhere to public sector procedures and policies; and,*
- make its decisions and appointments independently (especially from political intervention), particularly in making its senior appointments as we have noted in many other similar institutions.*

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?

In line with the previously expressed preference for industry ownership, the great majority of the Panel were not at all supportive of Elexon being taken into Public Ownership for two main reasons:

- the inefficiency of transferring Elexon first into public and then subsequently into private ownership – effectively the work will have to be done twice with obvious cost consequences; and,*
- there would be significant risk that it could well get “stuck” in public ownership because other policy priorities intervene, or indeed that political appetite to transfer Elexon back into private ownership wanes.*

The Panel was greatly concerned that the risk of not being able to transact any move to industry shareholders in time is so high that it believes it would be better to move Elexon directly to NGET to avoid the risk of public ownership.

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

See above for comments on Pension Fund liabilities

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

The Panel would like to see some consideration of the alternative of making the ownership a requirement of the Code (if implementing the “all Parties” option) as opposed to using Licence conditions to impose it.

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

The Panel would like to see additional risks imposed to the MHHS project and potential detriment to Elexon’s current operations included in the cost benefit estimation.