

Robert Clay
FSO@ofgem.gov.uk

National Grid ESO
Faraday House
Gallows Hill
Warwick
CV34 6DA

Kayte.ONeill@nationalgrideso.com
www.nationalgrideso.com

4th October 2023

ESO Response to Consultation on supply and generation licence conditions to implement new ownership arrangements for Elexon

Dear Robert,

Thank you for the opportunity to respond to your consultation on the proposed new electricity supply licence and generation licence conditions to implement the decision on future ownership of Elexon.

Who we are

As the Electricity System Operator (ESO) for Great Britain, we are at the heart of the energy system, balancing electricity supply and demand second by second.

Our mission, as the UK moves towards its 2050 net zero target, is to drive the transformation to a fully decarbonised electricity system by 2035, one which is reliable, affordable, and fair for all. We play a central role in driving Great Britain's path to net zero and use our unique perspective and independent position to facilitate network and market-based solutions to the challenges posed by the trilemma.

Our transformation to a Future System Operator (FSO) is set to build on the ESO's position at the heart of the energy industry, acting as an enabler for greater industry collaboration and alignment. This will unlock value for current and future consumers through more effective strategic planning, management, and coordination across the whole energy system.

Elexon ownership arrangements

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.

As noted in the consultation, in March 2023 DESNZ and Ofgem determined that Elexon would remain in industry ownership after the transition of the ESO to the Future System Operator (FSO) role, and that the shares in Elexon will initially be transferred to the 13 licensed BSC funding parties with a greater than 2% funding share in Elexon as of 1 January 2023. A transfer scheme made by DESNZ under powers set out in the Energy Bill will be used to effect this transfer. The arrangements under which Elexon governs itself will remain unaltered by this.

Our overall views on the proposals

We support the transfer of ownership of Elexon from the ESO and advocate that this should take place prior to the establishment of the FSO to decouple any possible risk from the FSO transition.

We note that this consultation on the changes to supply and generation licences is taking place alongside a consultation on the changes required to the BSC, including proposed changes to Elexon's Articles of Association which will additionally require shareholder approval by the ESO Board.

The ESO is currently required by condition C3 of its Transmission Licence to have in force and maintain the BSC which it does through its appointment of Elexon as the BSC Company. We note that no change is proposed to this licence condition alongside the supply and generation licence changes. Following transition to

the FSO, the FSO will be subject to a new Electricity System Operator licence. It is proposed in Ofgem's recently published informal consultation that this new licence will include a similar condition (E1 in the informal consultation) regarding the BSC, except that we understand the clause requiring the establishment of the BSCo will be removed if the transfer is achieved on or before the FSO day 1. We note that no further changes are proposed to either licence to accommodate the change in Elexon ownership; licence obligations will therefore continue to include the requirement to have in force and maintain the BSC, the establishment of an administrative function, code panel and other arrangements, and the setting out of the BSC objectives, processes and requirements.

Other than the ability as a party to the code to propose code modifications, both the ESO and FSO will have no ability to ensure compliance with their licence condition in this matter. We understand that this will continue to be the position until the BSC is 'designated' under the Energy Bill which will entail the appointment of a licenced Code Manager.

In order to ensure that the ESO/FSO is subject only to requirements which it is fully able to comply with, we would ask that further consideration is given to the removal of these licence requirements or to modifying the wording to acknowledge the relevant role that the licensee will play under the BSC. Alternatively, Ofgem could consider making provision for a derogation or dispensation to clarify the ability of the ESO or FSO to effect ongoing compliance, while noting that there is a need for continuity in the licensing of the BSC.

We look forward to continuing to work with you on the implementation of the new ownership model. Should you require further information on any of the points raised in our response please contact Rob Wilson, Corporate Governance and Frameworks Manager, at robert.wilson2@nationalgrideso.com.

Our response is not confidential.

Yours sincerely

Kayte O'Neill

Director of Transformation, Electricity System Operator

Appendix 1 – Consultation Question Responses

Question 1: Do you agree with our proposed approach to implementation, including our proposal for flexibility?

Yes. The proposals are a straightforward way of fulfilling the intent of the industry ownership proposals to allocate shares in Elexon to the largest BSC funders (in effect, the largest industry participants in the BM) while also making sure that such parties are subject to a licensing arrangement.

We note the necessary flexibility in allowing the party that is directed to hold a share through their licence to potentially be different, although within the same corporate group, to the entity qualifying for share ownership due to the extent of their BSC funding. In the cohort of shareholders as initially proposed we understand that this is straightforward and that generally the situation should never arise that a corporate group of this nature does not include a licensed party due to the nature of BM participation. The wording of the direction needs to be chosen with care to ensure that it is legally robust, stating a clear obligation to hold a share, while allowing the party directed the necessary flexibility to achieve this.

It is also necessary as proposed that arrangements are in place to allow the review and updating of the cohort of shareholders as dictated by changes in BM participation. For reasons of transparency it would be desirable to put directions in the public domain. A way of structuring the direction could be to make this a single publicly available document with an annex listing the current parties directed.

Question 2: Are there any other factors that we should consider to enable successful implementation?

It is essential to avoid introducing any contingent risks to the FSO transition programme in which the ESO will become the Future System Operator. We believe that the best way to achieve this decoupling is to complete the transfer prior to FSO day 1 (currently planned for mid-2024).

The most significant risk to timely completion is likely to be gaining approval from all of the new owners to their shareholdings and we would highlight this as being an activity that should be expedited, particularly given the multinational nature of some of the parties involved. Shareholders will continue the current 'arm's length' arrangements as with the current ESO ownership of Elexon; so shareholding does not confer control or create any liabilities due to the protections for and controls on shareholders which will be set out in the BSC. Documenting these arrangements and making sure that the BSC is updated is likely to be a part of achieving the necessary approvals from the new owners.

Question 3: Do you agree that the approach taken in the proposed licence condition serves the purpose required?

Yes. The proposed text is straightforward and does not inherently add any extra obligations to the involved parties since it will become effective only when directed by the Secretary of State or Ofgem.

Question 4: Do you have any additional comments on the proposed licence condition?

Regarding our preferred timing, this does introduce a transition period where the ESO will still be subject to its transmission licence until Day 1 of the FSO, when the FSO licencing arrangements will come into effect. So both the ESO's and FSO's licences need to be considered as part of the ownership transfer.

The current transmission licence Condition C3 as applies to the ESO sets out requirements for the ESO to have and maintain the BSC, including requirements to establish a BSCCo and code administrator. The objectives of the BSC, processes under which it may be modified, and general requirements for content are also set out in the licence condition. The ESO fulfils this condition in part through its establishment of and ownership of Elexon as the BSCCo. The FSO licence (condition E1 in the informal licence consultation) will include a similar condition to this. While the clause requiring the FSO to establish a BSCCo is left in the informal consultation document it is understood that this will be removed if ownership transfer is achieved on or before FSO day 1.

Once ownership transfer has been completed, the ESO and later FSO will be subject to a licence condition which they have limited control over, other than the continued ability to raise proposals for modification of the BSC. In particular, the ESO/FSO will have no power to veto changes to the BSC proposed by other parties. This is an anomalous situation that is likely to be resolved only when the BSC is 'designated' as allowed under the Energy Bill and a licenced Code Manager is appointed, since we understand from discussion that it is

desirable to maintain a licenced requirement on a party to have the BSC in force, and at which point it would be possible to move certain responsibilities under the BSC licence condition to the Code Manager.

While we would assume that the risk of any non-compliance by the ESO or FSO is low, since Elexon will continue to manage the code regardless of ownership arrangements and any material BSC modifications require approval by Ofgem, we would like to record these circumstances and note the ESO or FSO's limited influence. As noted above, we request that further consideration is given to addressing this.

Another area that is worth noting is that the ESO (and subsequently FSO) as the licensee is required (ref BSC section F 1.1.2) *'to give the Modification Secretary a notice of modification....in accordance with a direction of the Authority issued pursuant to the Transmission Licence'*. At present the ESO therefore has to give Elexon written instruction to implement any change. Elexon is also unable to raise modification proposals, since it is not a licenced code party, and the ESO therefore does this on its behalf when required.