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ESO Response to joint Government and Ofgem Statutory Consultation on ‘The Future Ownership of Elexon: new electricity supply and generation licence conditions and Balancing and Settlement Code (BSC) changes’

Dear Sir/Madam,

Thank you for the opportunity to respond to this statutory consultation on the proposed new licence and code arrangements required to implement the transfer of ownership of Elexon from the ESO to industry.

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 National Energy System Operator (NESO) in our role as the designated Independent System Operator and Planner (ISOP) 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 the Department for Energy Security and Net Zero (DESNZ) and Ofgem determined that Elexon would remain in industry ownership after the transition of the ESO to NESO, 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 further consultation on a draft of the changes to licence and code was undertaken in September 2023.

The 13 industry parties taking on ownership of Elexon will be directed to do so by DESNZ/Ofgem, and the actual transfer of shares to achieve this will be made through a transfer scheme drafted by DESNZ under the powers set out to do this in the Energy Act 2023. This transaction will have a nominal value of £1 per share. It is noted that further industry parties can also volunteer to become shareholders if they so wish. The arrangements under which Elexon governs itself, and its operational independence from its shareholders, will remain unaltered.

Our overall views on the proposals

We support the transfer of ownership of Elexon from the ESO to industry parties as part of the designation of the NESO as the Independent System Operator and Planner under the Energy Act 2023, noting that this will not intrinsically change Elexon's role or operation. We have previously advocated that if possible this transfer should take place prior to the establishment of the NESO to decouple any possible risk from this transition, however note the views of the department that as Energy Act 2023 powers are being used to direct changes to relevant industry documents associated with the designation of the ISOP then this cannot be done ahead of that designation, and also that no specific risks have been identified.

We would note that care needs to be taken in establishing and agreeing the deemed order of the actions that need to take place to implement the ownership transfer, most of which will take place on the transfer day itself although being prepared in advance, and would draw attention to two further areas, both of which are to do with the interaction between this ownership transfer and the designation of the ISOP:

- **Composite changes to the BSC** - various changes need to be made to the BSC as part of the designation of the ISOP and establishment of NESO including references to licences and to NESO itself. These will be developed in a separate BSC modification but assuming that the transfer and ISOP designation occur on the same day preparations will need to be made to make these changes along with the changes to facilitate ownership transfer in a composite form.
- **NESO's BSC licence condition** - the ESO is currently required by condition C3 of its Transmission Licence to have in force and maintain the BSC which it achieves through its appointment of Elexon as the BSC Company (BSCCo). Only minor changes are proposed to this condition when it is established as condition E1 'Balancing and Settlement Code' of NESO's Electricity System Operator Licence. The clause requiring the ESO to establish Elexon will be removed and the wording will clarify that NESO should have responsibility to progress matters only as within its control such as by raising code modifications. The BSC does though need to remain licenced and hence NESO will remain the licensee, so for example will continue to be required to instruct Elexon to implement code modifications once these have been approved through BSC governance. It is likely that this will continue until the BSC is 'designated' under the Energy Act which will entail the appointment of a licenced Code Manager. While the transfer and designation occurring at the same time removes any need for transitional arrangements we would note this unusual situation.

The consultation invited specific comments on:

- the policy approach;
- the draft licence condition, and whether this delivers the policy intent; and
- the BSC modifications (including the form of the AoAs), and whether these deliver the policy intent

which we will now go on to address.

The Policy Approach

We support the approach and note the further clarifications that have been provided in the consultation on the process by which parties will be directed, and the procedures that will be followed to maintain a suitable cohort of shareholders. We note that the main concern of the prospective owners has been around liabilities and that the consultation clarifies that as shareholders, and as is the case for the ESO as the current shareholder, the new owners will not have any liabilities.

The Licence Condition

The changes proposed to the generator and supplier licence standard conditions are largely as presented in the previous consultation with some clarifications added to the process by which a directed party can determine and communicate which part of its organisation or affiliate will hold the share. We support that these changes deliver the policy intent.

The BSC Modification, including the form of the Articles of Association

The modifications to the BSC sections C and X-1 are very substantially unchanged from the version consulted on in September 2023 and we support that these deliver the policy intent.

We specifically note with regard to shareholder liabilities that section C clause 2.4.1 that set out that the ESO as the BSCCo shareholder was not subject to any liabilities will be deleted but a new paragraph added to annex C-3 1.6 which reinstates the same provision for the new industry shareholders.

We would also draw attention to various places in the text where changes will need to be made as part of the designation of NESO as the ISOP. For example, section C clause 3.7 deals with 'Matters Relating to the Transmission Licence' but will need to be amended to refer to NESO's Electricity System Operator licence; and the definition of "Code" in section X-1 as *'meaning this Balancing and Settlement Code, as from time to time modified by the NETSO in accordance with the Transmission Licence; and references to the Code include the Code as given contractual force and effect by the Framework Agreement;'* will similarly need amendment. This definition also highlights the incongruity of the NESO remaining the licensee for the BSC and so needing to continue to instruct Elexon to make changes to the code.

Finally, in section C 1.5.2(b) the words *'...that is also a shareholder'* have been deleted from the version consulted on previously. We would recommend that these words are reinstated for clarity.

With regard to the Articles of Association, we note again that these are very substantially the same as consulted on previously. Procedurally, a draft of these changes was approved in principle by the ESO Board on 24th January 2024; a further confirmatory approval of the finalised version after this statutory consultation is concluded will be required. Again, due to the timing of the transfer date we would recommend adding a definition to the articles of the 'Electricity System Operator Licence', similarly to that made for the 'Transmission Licence', and to read *'means the Electricity System Operator Licence as defined in the Code from time to time'* which will avoid an inaccuracy or having to come back immediately to make a further change.

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

Colm Murphy

Head of FSO Programme, Electricity System Operator