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### **The Future Ownership of Elexon Limited (Elexon): new electricity supply and generation licence conditions and Balancing and Settlement Code (BSC) changes**

This is a non-confidential response to the above statutory consultation on behalf of Centrica Group. We have appended our comments to the draft Elexon Transfer Scheme Document for your convenience as the consultations are related, noting however that this is not a public consultation.

We welcome the opportunity to respond to the proposed licence conditions and BSC changes related to the transfer of Balancing and Settlement Code Company (**BSCCo**). We support the creation of the Future System Operator (**FSO**) and the need to address NGEN's shareholding in Elexon as the new public corporation is established. We provide our comments below to the policy approach overall, and then specifically to the BSC changes, Elexon's Articles of Association and the draft licence conditions.

### **Policy Approach**

We have contributed to the development of this policy since 2022 and consistently raised points relating to future uncertainties and liabilities that could arise from changes in policy that impact Elexon's activities and accountabilities, and/or conditions and obligations for shareholders. You state in the consultation document that no guarantee or cap on liabilities will be implemented through licence, and that the no obligation for shareholders to fund condition will continue in the BSC.

We note that in conclusion on this issue the consultation states: *If any future changes were proposed by industry, Ofgem, or the Government, they would be subject to the appropriate consultation processes and assessments.*<sup>1</sup> While the regular governance and consultation processes mitigate risk, we suggest below that additional measures are appropriate, including a

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<sup>1</sup> *The Future Ownership of Elexon: new electricity supply and generation licence conditions and Balancing and Settlement Code (BSC) changes*, 24 January 2024, paragraph 4.33.  
Page 1 of 8

right to veto or transfer shares in the case that shareholders suffer increased liabilities or obligations.

We have also consistently raised concerns about the treatment of the defined benefit pension scheme, both from our position as a future shareholder and BSC Funding Party. We respect the need for those most directly involved to be engaged and informed ahead of other parties. However, this has led to a lack of transparency and reassurance for BSC Parties. We continue to impress on you the need to reach the least-cost, most pragmatic outcome. We note that Ofgem considers a key principle for the outcome of the current Call for Input on pension scheme arrangements for National Grid employees transferring to the FSO to be that *“consumers should be held neutral in funding pension costs under the new arrangements”*.<sup>2</sup> Similar principles should be applied to the treatment of the Elexon pension arrangements, recognising that costs which fall on BSC Parties ultimately fall on consumers.

Therefore, our view, both as a BSC Funding Party and as a future shareholder in Elexon, is that the Elexon pension arrangements under its new ownership structure should not increase its ongoing pension costs and liabilities. If Elexon were to establish a new, standalone, defined benefit pension scheme, we consider this is:

- highly likely to result in additional costs, including those relating to the administration of the scheme;
- it will create uncertainty over changes in future ongoing pension costs arising from a potential change in employer covenant supporting the scheme, and
- it will also likely increase the risk of a Section 75 debt becoming payable by Elexon if/when Elexon colleagues who are currently building up pension benefits cease to be active members of such pension scheme.

Such additional costs and liabilities would be mitigated or removed if National Grid were to retain the management of pension arrangements for Elexon employees. In any event, to enable industry participants to fully assess the risks to them of being exposed directly to Elexon's pensions costs or liabilities, in their capacity as shareholders in Elexon, whether by virtue of The Pension Regulator's "moral hazard" powers to otherwise, we are requesting clarity over the future pension arrangements before being mandated to hold shares in Elexon.

Aside from the pension arrangements where (as noted above) clarity is lacking, we welcome the additional clarity provided in the consultation document on the approach to implementation. Some aspects would benefit from further detail though, in particular concerning the intended practical mechanics and status of certain policies outlined, for example:

- The process for determining which party must hold a share and how that responsibility may be delegated needs to be clarified. It's clear that a relevant authority can issue a direction to an electricity supply or generation licensee to hold a share. The directed licensee may, either before or after that direction, inform the relevant authority that it intends to delegate responsibility for holding the share to a wholly owned affiliate. Paragraph 4.17 of the consultation however appears to suggest that a relevant authority can also issue a direction directly to the wholly owned affiliate. We would welcome further clarity regarding what is intended to be captured please, as where the wholly owned affiliate is not a licensee the relevant authority would not have the power to issue such a direction. If the wholly owned affiliate is also an electricity supply or generation licensee, then a direction must be issued to the licensed party in accordance with the policy intent. This means that for the initial cohort, a direction would be issued to licensees who meet the qualifying threshold. The directed licensees may then delegate

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<sup>2</sup> *Call for Input – Pension scheme arrangements for National Grid employees transferring to the Future System Operator (National Energy System Operator or NESO)*, 14 February 2024, p. 2.

responsibility for holding the shares to a wholly owned affiliate, the wholly owned affiliate may also be the holder of an electricity supply or generation licence. Where there is a need to top-up, a direction would be issued to the licensed party who meets the top-up criteria. That party may then delegate responsibility for holding the shares to a wholly owned affiliate, the wholly owned affiliate may also be the holder of an electricity supply or generation licence. It is important that a clear process be followed to prevent confusion.

- We would welcome an opportunity to comment on the direction to be issued pursuant to the proposed licence conditions and should be grateful if you would provide a draft copy of the same.
- We would suggest that it is also possible better to reflect the policy intent in respect of which licensed parties shall or may be directed to hold a share by amending the proposed licence condition to include provision for the first direction and transfer of shares to a defined 'initial cohort', and the following process for 'top-up'.
- More information on the practical requirements would be helpful, including content of the notification, for informing the Secretary of State and Authority of a delegation or change of corporate relationship under the licence condition.
- The intention to maintain a minimum shareholder group of seven is not obligated under regulation or the BSC, no active review is planned, only reactive monitoring is outlined on the basis of shareholder notices, and topping up will be solely at the discretion of the Secretary of State or Authority. We suggest that clarity on this process is provided and triggers for topping up are put in place.
- The timing, anticipated sequence of events and actions from parties required to enable the initial share transfer need clarification.
- The policy intent is that future shareholders take neither control nor liabilities, and current BSC governance is maintained. As mentioned above and in our critical comments to the BSC changes below, protection is absent in the case of regulatory and procedural change affecting the BSC, or in the case of legislative change. The reform of code governance and proposed changes to Code Administrator / Code Manager (as defined in the BSC) roles increase risk in this area. Additional measures are required to maintain the policy intent.

## **BSC**

In this section, we have some over-arching, critical, comments on the proposed modifications to the BSC, set out immediately below, together with a series of more detailed comments on relevant paragraphs of the proposed new Annex C-3 of the BSC which are broadly intended to ensure each the scope of the new shareholders' rights and obligations match the policy intent and technically achieve that intent.

### **Critical comments**

We are reassured by much of the way Annex C-3 has been drafted to define the scope of the new shareholders' rights and obligations in their capacity as shareholders appropriately, subject to the more detailed points raised on a number of those provisions in Annex C-3 below.

However, that reassurance will only be sustained if in future there are no amendments to Annex C-3, or other provisions of the BSC, which have the effect of changing such shareholders' rights and obligations. If, for example, paragraph 1.6 of Annex C-3, which currently specifies that shareholders, in their capacity as such, have no funding obligations towards Elexon, were to change in the future, this would give rise to serious concerns. Similarly, that reassurance will only be sustained if in future no new legal requirements

come into force which cause Elexon to have to take a “relevant step” as defined and referred to in paragraph 1.6 of Annex C-3.

We are aware of the current processes and procedures which govern changes to the BSC. The current policy intent is that new industry participant shareholders of Elexon should not be exposed to additional liabilities in their capacity as such. However, the BSC change procedures do not give any Voting Party or Parties an absolute right to veto changes to the BSC, and the policy intent can change as can legal requirements applicable to Elexon. Therefore, we consider that it would be equitable for:

- a) the BSC to include an additional change requirement, for at least 75% of the shareholders of Elexon to have to approve any future amendments to the BSC, or to Elexon’s Articles of Association, where such change would have the effect of imposing on them any greater obligations or liabilities, in their capacity as shareholders, than those set out in the BSC and Articles as they are adopted pursuant to this consultation. An alternative solution, if this right of veto was not considered appropriate for some reason, would be to enable any shareholder to transfer its shares to the BSCCo Nominee if the BSC, or the Articles, were changed in a way which imposed greater obligations or liabilities on shareholders; and
- b) paragraph 1.8 to be amended to provide that, if Elexon is obliged to take a relevant step, as defined therein, any shareholder adversely affected by that step should be entitled to transfer their shares to the BSCCo Nominee or to another nominee designated by the Secretary of State.

### **Annex C-3**

1. Paragraphs 1.2.1(b), 1.3.2 and 1.4.3(c) – these paragraphs should be expanded to clarify when/in what circumstances the Elexon board of directors will approve a Party becoming an Eligible Party, when/in what circumstances it will refuse to register a transfer or allotment of shares to a Party and also when/in what circumstances an Eligible Party will be required to transfer its shares in Elexon, as leaving these matters to the discretion of the Elexon board will not necessarily achieve the policy intent for other Parties to be able to choose to be shareholders (and Mandated Parties should have clarity on who their fellow shareholders in Elexon will be). Further, if the policy intent is for there always to be a minimum of seven Mandated Parties, the BSC should give effect to this by specifying this as a minimum and specifying also how such minimum will be met if there are not at least seven Mandated Parties and Eligible Parties at any time.
2. Paragraph 1.3.3 - the directors of Elexon should be stated to be obliged to issue shares, and to register transfers of shares, to Mandated Parties, and should be stated to be prohibited from allotting shares and prohibited from registering the transfer of shares (and not just entitled to refuse to register any transfer of shares) to any other person. The terms of the BSC need to be expressly clear on these matters for Articles 3 and 8 of the proposed new Articles of Association to effectively bind the directors of Elexon to acting to give effect to the BSC in this manner.
3. Paragraph 1.2.3(a) and (b) - it is unclear how or why any shares in Elexon would have been transferred to any of the initial Mandated Parties prior to the Mandatory Transfer Ownership Date so, absent appropriate explanation of this, this words in square brackets in sub-paragraph (a) and the whole of paragraph (b) should be deleted.
4. Paragraph 1.3.1 - the mechanics envisaged in this paragraph, insofar as they relate to the initial Mandated Parties and in particular the suggestion that they must “apply to become a shareholder”, are inconsistent with the mechanics in the proposed revisions to Licences,

which mandate that licence-holders become shareholders, and in the Transfer Scheme Document, which simply effects a transfer of shares to the initial Mandated Parties without any application. This paragraph should therefore be amended to reflect the mechanics of the Licences and Transfer Scheme Document.

5. Paragraph 1.3.5 - we question whether this paragraph should refer to either the “nominal value” of shares and/or the “price” of shares, rather than the “nominal price” which has no legal meaning. That new shares in Elexon, on issue, should only be shares of £1 nominal value is understood, and that value or price should be stated as payable to Elexon (rather than the transferor) on issue (rather than on demand). This is consistent with point 1 of the procedural points we have raised to the Articles of Association below. We have no concern with the price of existing shares in Elexon, on transfer, being no more than £1 for each £1 share, and for that price to be payable by the transferee on demand by the transferor (and we assume the directors of Elexon are not concerned as to payment being made when registering such a transfer).
6. Paragraph 1.4.3 - the provisions of this paragraph which remain (see our point 1 on the BSC above) should be supplemented with: both (i) a requirement (similar to that included in paragraph 1.4.2) that the directors of Elexon be obliged to register any transfer of shares specified in this paragraph 1.4.3, such that, together with the revisions we have proposed to paragraph 1.3.3 of the BSC and Article 8 of Elexon’s Articles of Association, the directors of Elexon will clearly be bound to give effect to the BSC; and (ii) an obligation on BSCCo Nominee (who will need to be a Party to the BCS) to accept a transfer and pay the price for shares transferred to it. However, consistent with our procedural point 2 on the Articles of Association, the directors’ obligation to register transfers of shares, referenced in paragraphs 1.4.2 and 1.4.3, should be subject to being presented with a duly executed and certified as exempt from stamp duty instrument of transfer.
7. Paragraphs 1.4.4 and 1.4.5 - we do not consider paragraph 1.4.4 necessary, if our other proposed amendments, to ensure shares are fully paid on issue, and to ensure shares are transferred at a price equal to their nominal value, are already made elsewhere. It also does not seem necessary, or appropriate, for BSCCo Nominee to hold shares “on behalf of the other shareholders” as this creates the implication that other shareholders are somehow responsible for those shares, when that responsibility should be for BSCCo Nominee. Further, the reference to a Retiring Shareholder having to bear all the costs of transfer, if that part of the paragraph remains, should not extend to BSCCo’s or BSCCo Nominee’s costs or cut across BSCCo Nominee’s obligation to pay the transfer price. Further, while we have no objection in principle to what paragraph 1.4.5 is intended to achieve, we question whether it will have legal validity, as English companies are typically required to execute a power of attorney, by way of deed, in order to delegate authority to execute an instrument of transfer.
8. Paragraph 1.5.3 - please can the drafting of this paragraph be improved to ensure that it is clear that shareholders are only required to exercise their rights and take steps, in their capacity as shareholders, to give effect to the matters listed in paragraph 1.5.4 of the BSC. It is not clear why the Panel should be issuing any direction that the shareholders, in their capacity as such, would need to comply with, and to the extent any such direction purported to require them to do something beyond those matters specified in paragraph 1.5.4, this would not be acceptable. The interposition of the Panel direction wording in the sentence also breaks the sentence in a way to leave it unclear whether shareholders, in their capacity as such, are required to comply with all provisions of the BSC or just those in paragraph 1.5.4. To re-iterate, it should only be those in paragraph 1.5.4.

9. Paragraphs 1.5.4 and 1.5.5 - the matters listed in paragraph 1.5.4 (and included therein by virtue by paragraph 1.5.5) must be narrowed, specifically by: (i) removing sub-paragraph 1.5.4(c), as there is no legal requirement for shareholders of a private limited company to approve, or even receive, accounts, nor should the shareholders of Elexon have responsibility for doing so when they do not direct the affairs of Elexon; (ii) narrowing sub-paragraph 1.5.4(b) so that any appointment or removal of a secretary or auditor is only on the recommendation of the directors of Elexon, as the shareholders should not be responsible for such matters in the absence of such a direction; (iii) narrowing sub-paragraph 1.5.4(e) so that it only refers to matters which must (rather than can) be done by shareholders, as again the shareholders should not have responsibility for matters than can but are not required to be done, a good example being to approve or ratify a breach of the Elexon directors' duties which the shareholders should not be obliged to do; (iv) incorporating sub-paragraphs 1.5.5(a) and 1.5.5(b) within paragraph 1.5.4 but narrowing both matters so they are only done on the recommendation of the directors of Elexon, as it should not be for the shareholders to independently decide to do these things; and (v) removing sub-paragraph 1.5.5(c) as this potentially extends the matters shareholders are responsible for doing beyond matters already in the list, including matters which they can rather than must by law do. These amendments are critical to ensure shareholders are not required to do more than the bare minimum required by law, which is all that can reasonably be expected of them when they have no financial or controlling interest in Elexon.
10. Paragraph 1.6 - as referenced in our critical comment above, the continued inclusion of this provision is welcome, but the new shareholders should have assurance that this, and other provisions of the BSC defining the scope of their rights and obligations as shareholders, will not be amended in future in a way which would adversely affect them, either by a 75% majority of such shareholders having a veto right over such amendments or through each shareholder having the right to transfer their shares to the BSCCo Nominee or another nominee designated by the Secretary of State. We would also comment that, the fact the new shareholders are being asked to acknowledge in sub-paragraph 1.6.1 that Elexon is a limited liability company is interesting without them having the benefit of a warranty from the Transferor to this effect. Please see our substantive point 1 on the Transfer Scheme Document regarding the request for a warranty that would give the Transferees the comfort needed to give this acknowledgement.
11. Paragraph 1.7 - please can the "waterfall" in this paragraph be clarified, as it is currently unclear how sub-paragraph 1.7(a) (under which all assets of BSCCo are to be transferred to a successor) interacts with sub-paragraphs 1.7(b) and 1.7(c) (under which assets are distributed out to the Trading Parties or to settle certain potential shareholder tax liabilities). The correct waterfall will presumably depend on the circumstances under which BSCCo is being wound-up.
12. Paragraph 1.8 - as referenced in our critical comment above, while we welcome the inclusion of paragraph 1.8 and it goes some way to addressing concerns about the impact on shareholders of Elexon taking steps in future that could result in such shareholders having greater obligations or liabilities than they anticipated at this time, it does not fully resolve that concern if Elexon is obliged by law to take those steps. Therefore, to fully resolve this concern, we suggest that, in these circumstances, shareholders should be entitled to transfer their shares to the BSCCo Nominee or to another nominee designated by the Secretary of State.
13. Paragraph 1.11 - we would request that, either this paragraph is deleted, on the basis that the Annex does and should set out clearly all relevant obligations on the shareholders and a further assurance clause therefore simply creates confusion as to what else shareholders are required to do, or at least that the drafting is amended by deleting the words: "in order to

carry out, evidence and confirm their rights under, and the intended purpose of, this Annex” and replacing them with “in order to give effect to this Annex” so that it is clear the further assurance requires no more than co-operation between shareholders to meet the obligations set out clearly in the Annex. It is unclear for example what would be required of a shareholder in terms of “evidencing” or “confirming” its rights, or what the intent of the Annex is if this is not already successfully achieved through the actual provisions of the Annex.

## **Articles of Association**

On the Articles of Association, we have categorised our comments into those which are substantive, and those which are more procedural or relate to drafting:

### **Substantive points**

1. Article 47 (Status of Code) of the draft new Articles of Association goes too far, by requiring the members of Elexon to give effect to the terms of the BSC, as the BSC deals with matters that go far beyond those which the shareholders in Elexon can, or should, be responsible for. This provision must therefore be narrowed to those matters set out in paragraph 1.5.4 of Annex C-3 of the BSC only (and please also see our proposed amendments to Annex C-3 above). Any wider obligation is unacceptable.
2. We suggest Article 25 (Casual vacancy) is deleted, as it is inconsistent with Article 26 and the general principle that the directors are appointed by BSC Voting Parties in accordance with the terms of the BSC.

### **Procedural points**

1. In Article 3 (Directors’ powers to allot shares), while it is noted that the powers conferred on Elexon’s directors to allot shares are (appropriately) subject to the BSC, please note our point 2 on the BSC above. It is also suggested that the directors’ powers should be further confined to ensure that only shares of £1 nominal value each may be issued, that they must be fully paid-up on issue and that only shares of the same class, which rank *pari passu* in all respects with existing shares, can be issued.
2. In Article 8 (Right to refuse registration), while it is noted that the directors may not approve any share transfers other than in accordance with the terms of the BSC, please note our point 2 on the BSC above. It is also not clear from the drafting whether the reverse is true, namely that they must register share transfers where the BSC requires, for example under paragraph 1.4.3(b) or paragraph 1.4.2 of Annex C-3 of the BSC. We consider that Elexon’s directors should be subject to such obligation so that the provisions of the BSC (which are not themselves binding on directors of Elexon) can have effect, however such obligation would also need to be subject to the transferor presenting a valid and duly executed and duly stamped or certified as exempt from stamp duty instrument of transfer, as we note the Transfer Scheme will not operate to transfer shares subsequent to its implementation.
3. The drafting of Article 13 should be corrected, by ensuring the words after the comma in Article 13.2 apply equally to Article 13.1.
4. The drafting of Article 37.1(D) should be corrected to include the term which is being defined.

## **Licence Condition**

1. We would suggest that the definition of “Elexon” and subsequent references be replaced with “Balancing and Settlement Code Company (BSCCo).” For regulatory purposes we are referring to the BSCCo, Elexon is the entity currently appointed to perform that role. Referring to the BSCCo would reflect a conventional drafting approach, consistent with the Transmission Licence as well as the BSC. Please see suggested alternative drafting as follows:

“Balancing and Settlement Code Company means the Balancing and Settlement Code Company (BSCCo) pursuant to standard condition C3 (Balancing and Settlement Code (BSC)) of the Transmission Licence, and provided for in the Balancing and Settlement Code”

2. Our understanding of the policy intent is that an electricity supply or generation licensee, who is also a BSC funding party, may be directed to hold a share in BSCCo. Therefore paragraph 1 of the proposed licence drafting should be amended to reflect this.
3. Our understanding of the policy intent is that an electricity supply or generation licensee who has received a direction to hold one share in the BSCCo may delegate that responsibility to a wholly owned affiliate who is also a BSC funding party. Paragraph 2 of the proposed licence drafting refers to a “signatory of the BSC” rather than a BSC funding party. We would suggest that paragraph 2 be amended to better reflect the policy intent.
4. Paragraph 3c contains a typographical error, with the word “be” omitted. Please see corrected drafting:

“if the party to whom responsibility is delegated ceases to be a wholly owned affiliate of the licensee”

5. We would suggest that the licence condition include a definition of “wholly owned affiliate”. As an example, standard condition C3 of the Transmission Licence contains references to “affiliate of the BSCCo” and defines such as meaning “...any holding company or subsidiary of the BSCCo or any subsidiary of a holding company of the BSCCo, in each case within the meaning of section 1159(1) of the Companies Act 2006.” An appropriate definition of wholly owned affiliate would ensure that all readers are clear on its meaning.

We would be happy to discuss the points raised above should you require any clarification.

Yours sincerely

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