

Rachel Fletcher
Acting Senior Partner, Distribution
The Office of Gas and Electricity Markets
9 Millbank
London
SW1P 3GE

6th January 2012

Dear Rachel

May I first of all wish you, and your team, a Happy New Year.

I'm writing to you on behalf of the BSC Co Board, in response to your consultation on the proposed extension of the vires of the company.

As one proposed way forward would involve the outsourcing by the BSC Co to an independent company of almost all the current activities of the BSC Co, which obviously would have a very significant impact on the current management and staff of the BSC Co (Elexon) we as the Board have made it clear to the management team that we would have no objection on this occasion to them submitting a separate response to you should they wish to do so (and I understand that they have in fact done so). This letter, therefore, represents the views of the BSC Co Board only.

The Board agree that the company has very valuable skills and experience to offer to the energy sector, particularly in the area of settlement and other central arrangements, and in a number of cases, because of its current activities, where it is uniquely well placed to extend its role into other, related, work, to the benefit not just of the industry itself but of other important stakeholders, particularly the consumer. As a secondary, but still very important consideration, in the Board's view, is that the management and staff of the business, its most valued assets, should see the company as having a continuing and extended role into the future, rather than be destabilised by the prospect of gradual decline, as technology and other changes occur. Without both stability, and this motivating factor, there is a serious risk that there will be a heavy loss of experienced management and/or staff looking to develop their careers (something we are already starting to see), and this could have a profoundly adverse effect on the company's crucial current major role, in support of the Balancing and Settlement Code.

For these and other reasons the BSC Board fully support the proposed change of vires to allow the current BSC Co to extend its activities to other, appropriate and related, activities,. But this is only subject to a number of important key principles, which the Board established early last year in its discussions on the vires proposals, and which it reaffirmed in November, as part of its consideration of the Elexon business plan.

The complete list of these principles is attached as an annex to this letter, but amongst the most important of these, as you would expect, is of course that the core business of supporting the BSc in an efficient manner is not damaged by any engagement in other activities. A second is that any additional costs from other activities are borne only by those involved in that area of activity, so that there is no cross subsidy. A third, the thought underlying the fifth and six, and indeed seventh principles in the attached list, is that the underpinning 'mutual' type approach of the BSC, essentially as a not for profit, or not for dividend, organisation continue as being the best way to ensure

minimum costs and maximum benefits for the various stakeholders in the sector. This is regarded as important both in preventing unnecessary 'leakage' of profits outside the sector, and to inhibit the domination of the BSC (or other, related, future activities) decision making processes by a small number of self interested parties, to the detriment of competition, and of stakeholders in the industry as a whole, including consumers as well as putative new entrants. It is therefore important that any profits or other benefits continue to be shared to the benefit of all stakeholders, and, in particular, that the governance of activities continues to be for the benefit of all stakeholders, not a few.

A range of different approaches to the extension of Elexon's vires have been suggested in the consultation document. Whilst understanding and agreeing with Ofgem's focus on the need to have safeguards in place to prevent unfair cross subsidy of activities, and to also ensure that each separate activity carried out by Elexon is done so efficiently and effectively, the Board were of the view that the strict contractual approach mooted would be unnecessarily cumbersome and disproportionately expensive in relation to the relatively small proportion of Elexon's budget that is not already outsourced. And the short term suggested for the initial contract would simply make that issue worse. They feel instead that strong corporate governance (acting in the interests of all stakeholders) and properly audited accountancy practices were sufficient in themselves as a safeguard against the concerns expressed. The issue of multiple activities being carried out for different stakeholders by one company within a regulated sector is a common occurrence and is regularly dealt with in this way, without introducing an over rigid approach which will add cost, both in transition to a new approach, and in it's continuing operation. If in spite of this a formal structure is still felt necessary an arrangement which more resembled that of a licence rather than a contract would be more workable.

I should however also be very clear that the Board have expressly stated that, whatever the outcome of the consultation, they would want to do their best to implement any proposed changes effectively and efficiently. They also however recognise that, if any extension to the BSC Co's, vires is implemented, there will probably have to be changes in both the Board's composition, and in the way it operates. If a contractual model is chosen, this in particular would suggest that the BSC Co Board would need enhancing through the addition of members who are experienced in both procurement and in contract management. They are therefore very keen to take up your invitation to engage in continued discussions with you and your team, as your thinking evolves, and before you come to a firm conclusion. We are also in the process of acquiring sources of independent external advice to reflect the possible future divergence of interest between the BSC Co on the one hand, and Elexon and its management team on the other.

I look forward to our continuing discussions.

Yours sincerely,



Andrew Pinder
Chairman

Annex.

List of necessary principles to underpin any Vires extension, agreed by the BSC Board in discussions in March and restated in November 2011.

1. Ensure that existing core BSC business services are maintained and that there is no dilution of BSC resources and expertise
2. Enable the creation of an appropriate corporate structure for existing and new activities of the ELEXON Group that supports current and future market developments
3. Ring-fence liabilities, costs and risks for current and new activities (to protect the interests of BSC and other relevant Parties)
4. Provide for an appropriate legal and regulatory framework
5. Maintain independence
6. Allow for a fair reflection of current and future stakeholder interests
7. Avoid any unfair competitive advantage/disadvantage
8. Enable appropriate funding