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Dear Jon

**Potential Expansion of the Role of Elexon (ref: 154/11)**

Thank you for the opportunity to respond to Ofgem's open letter consultation on the potential expansion of the role of Elexon. This response is provided on behalf of National Grid Electricity Transmission plc (NGET). NGET owns the electricity transmission system in England and Wales and is the National Electricity Transmission System Operator. It is responsible for administering the electricity Connection and Use of System Code (CUSC), the Grid Code and the System Operator – Transmission Owner Code (STC).

NGET is also the Transmission Company as defined in the Balancing and Settlement code (BSC) and is accordingly the parent company of Elexon in accordance with Section C of the BSC.

We provide general comments here; our responses to the questions outlined in Appendix 2 of the consultation are provided in the attached Appendix.

We consider that the conditions set out for the expansion of Elexon's<sup>1</sup> role are appropriate and provide a useful framework for assessing the two models, namely, the subsidiary model and the contract model. We also agree that it is appropriate to rule out the third model which proposes to expand Elexon's role within the BSC.

We broadly agree with Ofgem's assessment and the rationale for preference for the contract model.

The contract model envisages clear separation between BSCCo and New Elexon via an arms length, commercial contract arrangement. This means that the BSC Parties' responsibilities for funding BSCCo remain clear and that they will not be exposed to risks which are unrelated to the BSC activities which they fund. However, it should be noted that the level of costs faced by the BSC Parties under such a model will depend on the profit margin built into the contractual arrangements.

If the contract model is implemented, we consider that the BSCCo should retain sufficient assets to ensure that it can step in and ensure service continuity in the event of failure of the new service provider which is initially envisaged to be New Elexon.

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<sup>1</sup> In this response, the term New Elexon is used to represent the company which would carry out non-BSC activities (the terms BSCCo and Elexon are interchangeably used to represent the organisation performing the BSC-related activities, both now and in the future).

It is evident from the consultation that the subsidiary model will be dependant on robust ring-fencing of resources to ensure that the BSC Parties do not face higher costs or additional risk. One possible option stated in the consultation to enforce such ring-fencing obligations is to include a provision in NGET's transmission licence. NGET is strongly opposed to the extension of such regulatory obligations within its transmission licence because we consider that it is inappropriate to burden a licensee with regulatory obligations unrelated to its licensed activities and conducted by a third party. It also is not clear how such obligations would be discharged by NGET given that, under this model, the ownership of BSCCo would transfer to a new Elexon HoldCo and NGET would have no direct link with Elexon. In any event, NGET would need to carefully assess the implications of such an obligation and any associated risks. Regardless of who may be required to carry out this role, the monitoring and enforcement of the ring-fence is likely to be a significant challenge.

If you wish to discuss this further, or have any queries regarding this response, please contact me on 01926 653190 ([paul.whittaker@uk.ngrid.com](mailto:paul.whittaker@uk.ngrid.com)).

Yours sincerely

*[By e-mail]*

**Paul Whittaker**  
**UK Director of Regulation**

## **APPENDIX**

### **Responses to questions in Ofgem consultation**

#### **Q1. Do you consider that we have set the right conditions for a potential expansion of Elexon's role?**

Under NGET's Electricity Transmission licence, we are required to have the BSC document in place. Although we are not responsible for the day-to-day operation of the BSC, we consider that any changes to the corporate structure of Elexon should have minimal impact on the BSC-related activities. We therefore agree with the primary aim that any changes to the Elexon role should not put the existing BSC arrangements at risk. NGET considers that the first three conditions could help achieve this aim:

- BSC Parties should not face higher costs;
- The arrangements should not place more risk on BSC Parties;
- Standard of service should be maintained

NGET considers that the fourth condition aimed at ensuring competition for the DCC<sup>2</sup> is also appropriate.

#### **Q2. Do you consider a contract or a subsidiary model would better meet our conditions? Please provide reasons.**

Overall, we consider that the conditions would be better met by the contract model, as explained below.

The subsidiary model will require robust ring-fencing of resources (including staff and financial resources) to ensure that the BSC Parties do not face higher costs or additional risk. One possible option stated in the consultation to enforce ring-fencing is to include a provision in NGET's transmission licence. NGET is strongly opposed to the extension of such regulatory obligations within its transmission licence because we consider that it is inappropriate to burden a licensee with regulatory obligations unrelated to its licensed activities and conducted by a third party. It is also not clear how such obligations would be discharged by NGET given that, under this model, the ownership of BSCCo would transfer to a new Elexon HoldCo and NGET would have no direct link with Elexon. In any event, NGET would need to carefully assess the implications of such an obligation and any associated risks. Regardless of who may be required to carry out this role, the monitoring and enforcement of the ring-fence is likely to be a significant challenge.

NGET notes that a key benefit of the subsidiary model could be the synergies resulting from sharing of expertise between BSS Co and New Elexon. However, a robust ring-fencing of resources (including physical separation) might impact the extent to which skills, knowledge and experience might be transferred, thereby risking non-delivery of some of the envisaged benefits.

The contract model envisages clear separation between BSCCo and New Elexon via an arms length, commercial contract arrangement. This means that the BSC Parties' responsibilities for funding BSCCo remain clear and that they will not be exposed to risks which are unrelated to the BSC activities which they fund. However, it should be noted that the level of costs faced by the BSC Parties under such a model will depend on the profit margin built into the contractual arrangements. As stated in the consultation, there may be ways (e.g. to initially enter into the contract on an 'as-is' basis) to mitigate this risk.

#### **Q3. Do you consider that the role of the BSC Panel should change in response to a change in the role of Elexon?**

In our view, there may be some marginal change to the role of the BSC Panel depending on the chosen model but that substantive roles and duties will remain largely unaltered under either model.

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<sup>2</sup> Data and Communications Company which will be created by DECC to manage smart metering

**Q4. Would the current arrangements for the BSCCo Board allow it to fulfil any additional responsibilities and mitigate any risks associated with the expansion of Elexon's role?**

NGET has no specific comments on any additional responsibilities for the BSCCo Board at this stage although clearly current arrangements and the provisions of Section C 4 of the BSC will need to be reviewed to ensure ongoing suitability and robustness should either model be implemented.

**Q5. Do you consider that the existing role of NGET in the BSC, in particular its ownership of the BSCCo and licence obligations, should be reconsidered and in what way?**

The current governance arrangements, including NGET's ownership of BSCCo and relevant licence obligations, were put in place some time ago for a single purpose i.e. to deliver the BSC provisions. If Elexon's role is to change, it will be appropriate to review the existing arrangements. We would like to make the following specific comments on the issue of ownership and relevant licence obligations.

NGET ownership of BSCCo

NGET is currently the sole shareholder of BSCCo but BSCCo is effectively an uncontrolled subsidiary. As provided by Section C2 of the BSC, NGET has only limited rights and obligations as BSCCo shareholder including no obligation to finance BSCCo and the constitutional documents can only be changed in accordance with the BSC modification procedures. NGET has no representation on the BSCCo Board. Furthermore, NGET cannot transfer ownership of BSCCo without direction from the Authority.

NGET's Relevant Obligations

Standard Condition C3 of NGET's licence includes limited 'step-in' provisions (e.g. operation of the BSC modification procedures if BSCCo fails to perform this role). NGET considers that such provisions are important to have in place as a back-up although it may be appropriate to review whether NGET continues to be the best-placed party to perform this role. As stated above, NGET is strongly opposed to the introduction into its transmission licence of further obligations associated with the expansion in role of Elexon. Existing obligations relate specifically to having in place the BSC with specified objectives and procedures for modification. It is inappropriate to burden a licensee with regulatory obligations unrelated to its licensed activities and conducted by a third party.

**Q6. Do you consider that the BSC Board is appropriately constituted and resourced to deliver its enhanced role, including the negotiation of contracts?**

We assume that the reference here to 'BSC Board' means the 'BSCCo Board'. NGET has no specific comments on the constitution of the BSCCo Board at this stage although clearly current arrangements and the provisions of Section C 4 of the BSC will need to be reviewed to ensure ongoing suitability and robustness should either model be implemented.

**Q7. Do you consider that the BSC should be given a right of 'step in'?**

We assume that the reference here to 'BSC' means the 'BSCCo'. NGET considers that it is important for the BSCCo to have a right of 'step in' in case New Elexon is unable to deliver the services required by the BSCCo due to service failure or future non appointment. The ability to step in will, of course, require the retention within BSCCo of certain core assets and functionality and the extent of such retention will inevitably impact on the viability of New Elexon as a viable service provider.

**Q8. What are your views on the best way to overcome the implementation challenges?**

The consultation states that DECC's anticipated timeline (although not a primary concern) is a relevant consideration. We conclude that a 'minimal change' approach may be best suited to achieve timely implementation. This means minimal changes to the licence (if any) and the BSC.

Under the contract model, the level of changes envisaged by Ofgem is significantly less than under the subsidiary model, with potentially no changes required to any licence conditions. The contract model could therefore be implemented relatively quickly.

**Q9. Do you agree with our assessment that a contract could provide a relatively straightforward way of giving BSC parties confidence that they are not being called upon to carry the costs of new activities?**

Yes, NGET agrees with this statement.

**Q10. If the contract model is adopted, do you consider it a viable option to create a contract on the basis of “as is” service levels and costs (+ margin to be negotiated) for a relatively short period with a requirement on the BSC to retender after a period of x years? If so what period do you consider appropriate?**

The ‘as is’ approach for service levels and costs seems pragmatic and appropriate. Although NGET has no specific views on the duration of such arrangements, any period determined should be of sufficient duration to provide stability prior to any competitive tendering for BSC services.

**Q11. If the contract model is adopted, which assets, if any, do you consider should remain with the BSCCo or be transferred to the new Elexon?**

Our general view on assets is that the BSCCo should retain sufficient assets to ensure that it can step in and ensure service continuity in the event of failure of the new service provider. This may mean, among other things, the retention of appropriate levels of staff by BSCCo; another advantage of this, if the staff who remain are active members of the NGET pension scheme, is that it will avoid triggering a potential debt/cost under the s75 statutory regulations Pension Act 1995 (as amended by PA2004).

**Q12. If the contract model is adopted, what approach do you consider most suitable for ensuring that incentives exist for performance, that service levels are sufficiently defined and secured, and that value for money achieved?**

We have no specific comments on this issue at this stage.

**Q13. Do you consider that in the event the subsidiary model is adopted, a ring fence would provide a suitable safeguard of BSC Parties interests? Specifically, what are your views on:**

It is evident that under such a model sufficient safeguards would need to be implemented in order to provide suitable safeguards to BSC Parties. However our general view is that a ring-fence around the BSC activities would be difficult to monitor and challenging to enforce. We provide additional views in the following subsections.

**a. The BSC Panel’s ability to effectively hold Elexon to account under the subsidiary model?**

We assume that the reference here to ‘Elexon’ means the ‘BSCCo’. As a member of the BSC Panel, NGET considers that robust ring-fencing of the BSCCo would be necessary for the Panel to oversee activities of the BSCCo and perform its role effectively. As stated in our response to Q2, ensuring robust ring-fencing is likely to be a challenging task which means that the Panel may not be able to effectively hold BSCCo to account under the subsidiary model.

**b. Whether enhancing NGET’s licence to put new responsibilities on them in respect of any ring fence provision would be a suitable approach?**

As stated above, NGET is strongly opposed to the introduction into its transmission licence of further obligations associated with the expansion in role of Elexon given the lack of clarity as to how the obligations would be discharged and the consequences of non compliance. We agree with the observation in the consultation that it would not be an appropriate sanction to seek to impose a financial penalty on NGET in relation to any such ring-fencing monitoring.

Existing obligations relate specifically to having in place the BSC with specified objectives and procedures for modification. It is inappropriate to burden a licensee with regulatory obligations unrelated to its licensed activities and conducted by a third party.

It is also not clear how such obligations would be discharged by NGET given that, under the subsidiary model, the ownership of BSC Co would transfer to a new Elexon HoldCo and NGET would have no direct link with Elexon.

**c. Whether it would be better to do this through a new licence which would make Ofgem responsible for enforcement?**

This option, to make BSC arrangements a licensable activity, would provide Ofgem with a direct enforcement route to the entity charged with discharging the relevant activities and would more appropriately target the regulatory risk of delivery. However, such an option will presumably take some time to implement given the scope of existing licensable activities within section 6 of the Electricity Act 1989 and so may not be compatible with currently expressed timescales.