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Dear Rachel

Potential Expansion of the Role of Elexon

RWE npower welcomes the opportunity to comment on the consultation. This response is provided on behalf of the RWE group of companies, including RWE Npower plc, RWE Supply and Trading GmbH, RWE Cogen and RWE Npower Renewables Limited, a fully owned subsidiary of RWE Innogy GmbH.

In the past year we have taken an active part in the discussions about the developing role of Elexon. During that time we have emphasised that above all Elexon maintains the integrity of the Balancing and Settlement arrangements as set out in the present Industry Baseline documentation. Subject to the appropriate measures in place to achieve this, we would have no objection to Elexon taking on other roles beyond the Balancing and Settlement Code Company (BSC Co). Implicit in this approach is that funding of, and resources used, by BSC Co are not compromised and there will be a clear distinction at all times between Elexon and BSC Co.

If, at the end of the consultation the Authority agrees to allow Elexon to proceed with its plans, the process should be quick and effective. This development will divert BSC Parties' resources from other developments in the industry, the development of Smart Metering, implementing Green Deal, the development of Codes of Practice for the detection of theft of gas and electricity, the Review of Xoserve and the reform of the Supply Point Administration Agreement. Parties will appreciate clear guidance and direction from Ofgem about how to proceed.

Answers to the specific questions in the consultation are set out in an Appendix to this letter. Naturally, we would be more than happy to discuss any aspect of them with Ofgem.

Yours Sincerely

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

Ideally, BSC Parties should experience exactly the same service from and BSC Co under a new structure as at present. We wish to see the service continue to improve and for any potential development of Elexon to have no impact on service quality, even during the transition to a new structure. Loss of quality could be caused by staff focussing on the development of a new company and its products and services. Ofgem should consider adding a fifth criterion; which would be clear business separation between BSC Co and Elexon, their staff, assets and resources. This may not result in complete ring fencing activities but rather that activities for BSC are distinct from those carried out for Elexon. This should go some way to ensure that the BSC Co service quality is maintained and such work is given appropriate priority.

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

Under either model the entity that provides a service to BSC Co will need to have clear service level agreements and Key performance indicators. Furthermore, the relative accountabilities of functions would have been set out.

In our view the subsidiary model is hard to manage; it does not make the necessary separation between entities and leaves too much risk with BSC Co and BSC Parties. The contract model is well established in the energy supply industry. The SPAA, MRA, DCUSA and DTSA all operate successfully under this type of model and we believe that the BSC could operate under it as well. The contract model would allow Elexon greater commercial freedom to diversify than if it were part of a subsidiary structure. It apportions the risk appropriately; for example in the event that Elexon were not successful in maintaining the contract for BSC Co, the subsidiary model would make it harder to separate it from BSC Co. Finally, the commercial disciplines required by BSC Co and Elexon of the contract model are well established and easier to manage effectively than the uncertain nature of the subsidiary approach.

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

The Panel's function is associated principally with Modifications and the performance assurance framework. This will not change with a new company structure. There will need to be an Executive Committee or similar body that would be responsible for managing the business functions and contract relating to BSC Co. However, one of the objectives of the development of Elexon should be no impact on the existing BSC functions and roles.

4. 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?

There is merit in reviewing the role of the composition and role of the Elexon Board. Its exact composition will depend on whether BSC Co has its own staff or contracts with a

service company such as Elexon. The Board's functions will need to extend to managing the service contract; there would be a reduced role for the present Executive Directors. However this will be counter balanced by an enhanced role for BSC Parties and Independent Directors.

5. 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?

BSC Co should remain solely to discharge the functions of the Balancing and Settlement Code. Ownership could be transferred to BSC Parties, based on a market share arrangement or a single share allocated to each party. As Parties presently provide the funding for BSC Co, it is logical that they own the company. The funding arrangements for the BSC mean that there would not need to be any capital investment. The trading arrangements are mature and stable; there is merit in using this potential development to transfer the ownership to BSC Parties and place a licence obligation on licensees to obtain the BSC arrangements.

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

No, with the potential changes we see that the Board's powers and composition need augmenting to reflect the enhanced roles and duties the Directors of BSC Co will have.

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

Yes, as compliance with the Balancing and Settlement Code is both a licence obligation and carries commercial risk to BSC Parties. In the event that the company providing services to BSC Co fail, Parties must have the ability to ensure continuity of service.

8. What are your views on the best way to overcome the implementation challenges?
Contract Model

Using the existing business processes as a guide, Ofgem, Elexon, National Grid and BSC Parties should agree with the BSC Panel and the Board a desirable set of services and SLAs. They should be transferred into a contract between BSC Co and Elexon to come into force once it has established a company to carry out this work. Meanwhile, Elexon should identify which staff and resource will work on the transfer, on BSC activities and on Elexon development processes so that these tasks do not become merged.

9. 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?

Insofar that the roles, responsibilities and SLAs are set out clearly in any contract, yes.

10. 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?

We do not see the need to place a margin onto the existing BSC costs. Elexon has shown that it has reduced the costs of operating the trading arrangements over the past 11 years. If the company believes that it can diversify successfully, it should do so on its merits, not with a margin guaranteed by BSC Parties. A contract of 5 years should provide certainty for Elexon to diversify and provide BSC Parties with adequate controls over the operation of BSC Co.

11. 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?

To answer this question with certainty requires sight of the existing contracts and liabilities, which we do not have. However, a general principle is that BSC Parties have, over the life of the Balancing and Settlement Code, funded the assets and should retain them wherever possible. Certainly, any rights to intellectual property and applications that are required for operation of the BSC should be retained by the BSC Co. A fixed duration contract with Elexon should provide adequate revenue for the company to operate and to raise funds for its development.

12. 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?

See answers to questions above

13. 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:
a. The BSC Panel's ability to effectively hold Elexon to account under the subsidiary model?

Elexon took little account of the wishes of BSC Parties in response to the BSC Plan in 2011; this suggests that unless Parties have ownership of BSC Co, their ability to offer any sanction over Elexon is limited. This would become more significant if there were conflicts between Elexon's commercial activities. For this reason we believe that the subsidiary model has no merits.

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

NGET has expressed no wish to become more involved in the operation of Elexon. If it were to there may be questions about the competitiveness of an Elexon that operated in a commercial market. Other companies could challenge Elexon on the grounds of being subsidised by a network operator.

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

See answers to the above questions.