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Open Letter Consultation: Potential expansion of the role of Elexon

Dear Rachel,

Introduction

SmartestEnergy welcomes the opportunity to respond to Ofgem's Open Letter Consultation: Potential expansion of the role of Elexon.

We note that Ofgem considers that there may be some synergies between the processes currently run by Elexon and the anticipated role of the DCC, as well as the potential for cost savings from the more efficient use of its fixed assets and other resources. We are in full agreement with this and feel that the preservation of those synergies should be the deciding factor when choosing which model to adopt.

We note that Ofgem are happy to receive views on Option 1 and, regrettably, we agree that realistically it will have to be discounted at this stage in the context of the immediate opportunity to operate as the DCC which must be seen as one of the greater opportunities for Elexon. This does not mean, however, that this could not be an option for the future. Indeed, there is nothing preventing the development within the BSC.

We note also that Ofgem's view is that BSC Parties should not be exposed to additional costs as a result of any expansion of Elexon's role. Our view, however, is that exposure to additional costs may be appropriate if the expansion is into a related area and it can be shown that said expansion would actually lead to synergies/reduced costs overall.

We agree wholeheartedly with conditions 2 and 3 viz that the arrangements should not place more risk on BSC Parties and that the standards of service should be maintained. We take issue with the suggestion that Elexon should not have an "undue" advantage

in the DCC competition; Elexon's unique position gives it an advantage which industry should be harnessing.

We note Ofgem's view that for a subsidiary model under a holding company to be workable there would need to be a strong ring fence in place to give BSC parties the assurance that they are not funding other activities in the group and that they are not exposed to additional risk. Ironically, such ring-fencing could restrict the advantages of the expertise which could be shared. Some degree of discretion is required.

In short, SmartestEnergy favours the subsidiary model over the contract model because we believe it will lead to greater synergy of expertise sharing. A contract model will lose this especially because it has a for-profit focus.

We note that many questions appear in the body of the consultation document and there is little overlap with questions in Appendix 2. For your convenience we have presented answers to questions as they appear in the document. We would like to make it known, however, that this consultation document has been the least consistent we have ever seen with regards to where questions appear.

Ofgem's questions within the body of the document

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?

It may be more straight-forward, but straightforwardness should not be an aim in itself, especially, as in this case, such an approach does not allow for any discretion where synergies are achievable but thwarted due to the contract structure.

Do you agree with our view that start up costs themselves do not provide a sufficient basis for determining the appropriate model?

Yes

Do you consider that the benefits of the contract model would likely outweigh the additional cost of a premium?

No

What resources/support would the BSC board need to negotiate the contract?

Clearly, significant resource would be required and this has to be a consideration against the contract model.

Do you consider that core assets and functionality should remain with the BSCCo or be

transferred to the new Elexon?

Again, this highlights a problem with the contract model; there would be greater synergies with other activities if transferred to the new Elexon. However, this may not be appropriate.

What are your views on which assets and functionality should be retained?

This is an impossible question to answer given our answer to the previous question.

Do you consider that the BSCCo should be given a right of 'step in'?

Yes.

Do you consider this approach [the initial contract between BSCCo and the service provider largely reproducing the existing arrangements] to be suitable for ensuring that incentives exist for performance and that service levels are sufficiently defined and secured in any contract?

We are not convinced that any KPIs would be able to capture the full value of the service provided.

We invite views on our assessment of the implementation challenge and particularly on whether the success of this model relies on Elexon securing a business partner.

We are of the view that the contract model is flawed if it is dependent on the new Elexon company attracting investment.

We welcome your views on what, if any, changes to current Elexon reporting arrangements would be required to provide BSC parties with the appropriate level of assurance that they are not funding non-BSC activities.

Rather than defining reporting arrangements it would make more sense if Elexon were to report on their activities and for the BSC Panel/Board to have the right to ask for clarification on any grey areas.

We welcome views on these issues and on the merits and enforceability of a ring fence of the BSCCo generally.

As previously stated a certain degree of discretion will allow for the synergies to be maximised. There will undoubtedly be areas of work which are wholly appropriate for BSC Parties to fund.

We invite views on this issue [special administration]

We see no reason to change the licence condition placed upon NGT and they should therefore have the right to "step in"

We invite views on this issue [service levels]

We are not convinced that service levels would be able to capture the full value of the service provided. A certain degree of discretion is required to allow for the synergies to be maximised.

We invite views on this issue [competition]

We agree with Ofgem's concerns here where the area of development is not purely electricity related and where centralisation does not bring benefits. Ultimately a process is required where Ofgem are the arbiter in these matters.

We invite views on our assessment of the implementation challenge

Quirky though it is we see no preferable alternative to the licence condition placed upon NGT.

Ofgem's questions in Appendix 2

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

We note also that Ofgem's view is that BSC Parties should not be exposed to additional costs as a result of any expansion of Elexon's role. Our view, however, is that exposure to additional costs may be appropriate if the expansion is into a related area and it can be shown that said expansion would actually lead to synergies/reduced costs overall.

We agree wholeheartedly with conditions 2 and 3 viz that the arrangements should not place more risk on BSC Parties and that the standards of service should be maintained. We take issue with the suggestion that Elexon should not

have an "undue" advantage in the DCC competition. Elexon's unique position gives it an advantage which industry should be harnessing.

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

We favour the subsidiary model because we believe it will lead to greater synergy of expertise sharing. A contract model will lose this especially because it is a for-profit focus

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

No, but we think the role of the Board will probably change in the way it relates to other boards within the chosen group structure.

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

The remit of the BSSCo board would need to be expanded.

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

No

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

No. The resource here is something of an issue.

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

Yes, as stated in previous section.

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

We have no view on this. Implementation is a problem whichever option is chosen.

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?

As stated in the previous section we see no preferable alternative to the licence condition placed upon NGT.

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?

Yes, contracting on the basis of "as is" service levels and costs (+ margin to be negotiated) is viable, but it is not sensible. Such a short term contract is not going to incentivise the maintaining of long term service outlook.

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?

As stated in the previous section this highlights a problem with the contract model; there would be greater synergies with other activities if transferred to the new Elexon. However, this may not be appropriate.

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?

No comment.

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?

Ofgem will need a role to ensure fair play.

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

Yes, this would be a suitable approach

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

We are not convinced a new licence is necessary, merely an alteration to the existing licence.

Should you wish to discuss any aspect of this matter, please do not hesitate to contact me.

Yours sincerely,

Colin Prestwich
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