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# Potential expansion of Elexon's role: Stakeholder workshop

8 December 2011

## Content of the workshop

### Part A: Contract and subsidiary model (60 mins)

1. Ofgem's preliminary view and reasons
2. Elexon's preliminary response
3. Discussion

### Part B: Implementation (60 mins)

1. Key elements of both models
2. Detailed tasks and timelines
3. Next steps

## Ofgem's preliminary view

- Supportive of Elexon's desire to bid for DCC (and potentially other roles) – purely an implementation issue
- "Contract" or "subsidiary" model may be appropriate, subject to four conditions:
  1. BSC parties do not face higher costs
  2. BSC parties do not face higher risks
  3. BSC activities not compromised by focus on other roles
  4. Elexon not given unfair advantage in DCC bid
- Preliminary view – contract model may better meet conditions
- Both models subject to various implementation issues – in particular the need to raise equity to support newly created entities

## Key considerations against 4 conditions

Condition	Contract model	Subsidiary model
BSC parties do not face higher costs	Dependent on robust negotiations, introduction of profit margin. Some set-up costs	Dependent on robust ring fencing and accountability arrangements. Some set-up costs
BSC parties do not face higher risks	Dependent on negotiations and allocation of assets to/ equity held by outsourced service provider. Contract duration important in risk allocation	Dependent on ring fencing arrangements and equity held by corporate group
BSC activities not compromised by focus on other roles	Dependent on ability of BSCCo to effectively delegate obligations through contract	Question incentives on corporate group/ ability of BSC Panel to ensure BSCCo performance is maintained
Elexon not given unfair advantage in DCC bid	Dependent on cost allocation and non-discriminatory access to BSCCo info/ systems	Dependent on cost allocation and non-discriminatory access to BSCCo info/ systems

## Key considerations (continued)

- Counter-party tension/ contract negotiations more likely to result in BSCCo interests being protected (costs, risks and service quality)
- Unclear how subsidiary model would enforce ring-fencing and service quality obligations
  - At present, closest regulatory “hook” is NGET’s licence
  - Unclear governance relationships between parent and subsidiaries
  - Incentive for corporate group to shift costs from DCC (profit making/ incentive arrangements) into BSCCo (cost pass-through arrangement)
- Both models require splitting up of/ sharing existing BSCCo resources and new equity raising, but potentially simpler under contract model

## **Elexon preliminary response and stakeholder discussion**



## ELEXON's observations

- We welcome the launch of the consultation
- We agree with the 4 Conditions
- We believe either model could be made to work, but there will be challenges:
- Contract Model
  - Duration - too short destabilises industry & staff, distracts, has higher costs and can't be monetised to provide funding
  - Implementation costs – we believe higher in contract model (contract negotiation, resourcing BSCCo, profit margin) and yet benefits can only be derived from c£10m of our costs (as c£20m is already tendered)
  - Timing - keep simple, stick to “as is” and a simple enforceable contract
  - Thick or thin BSCCo – we believe thin otherwise little is outsourced
  - Impact on behaviours – service company ethos vs mutual



## ELEXON's observations

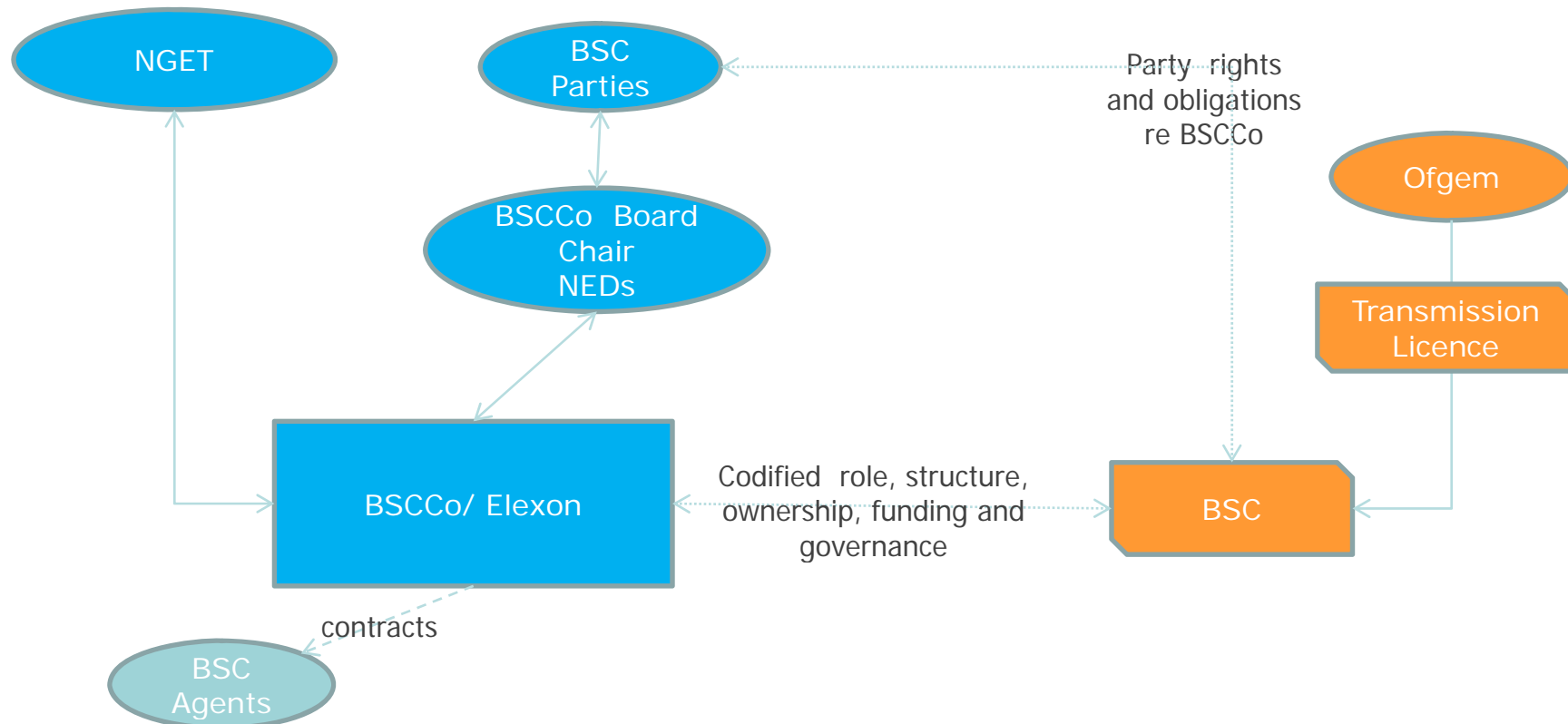
- Subsidiary model
  - Can overcome perceived ring-fence challenges – introduce step in and transfer back
  - Funding – BSC Party funding with agreement, repay via loan; or source equity from BSC Parties or from market. Not compulsory
  - Simplicity – keep “as is”
- Can't have ring fence and contract
- Ownership of “New ELEXON,” CLG v CLS. Not addressed in consultation. In CLG:
  - Open membership – new entrants can become members
  - No capture/control by subset of industry
  - No distributions – so reinvest profits in industry, or offset costs
  - Board to reflect Good Corporate Governance



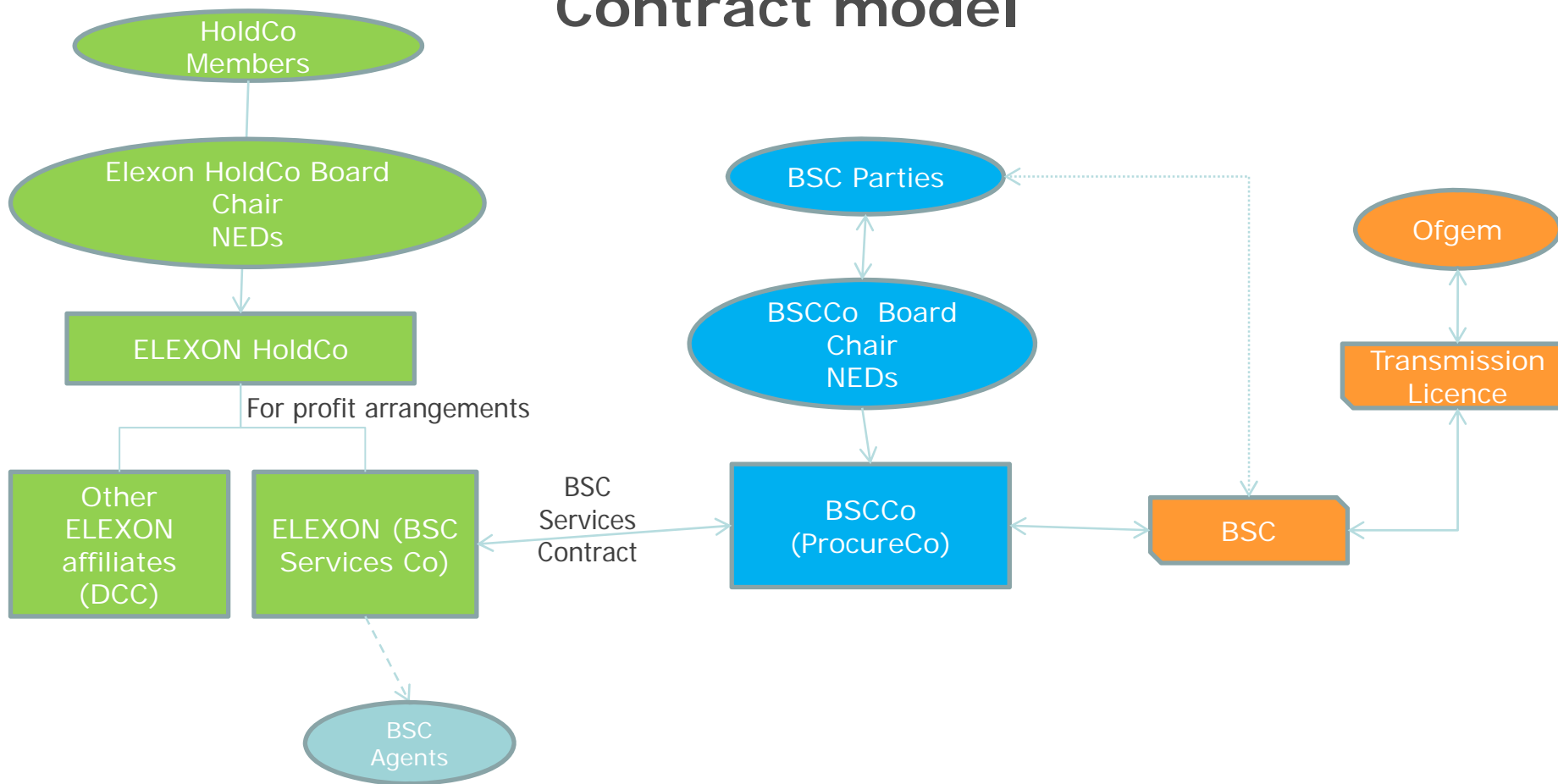
## Part B: Implementation

1. Key elements of both models
2. Detailed tasks and timelines
3. Next steps

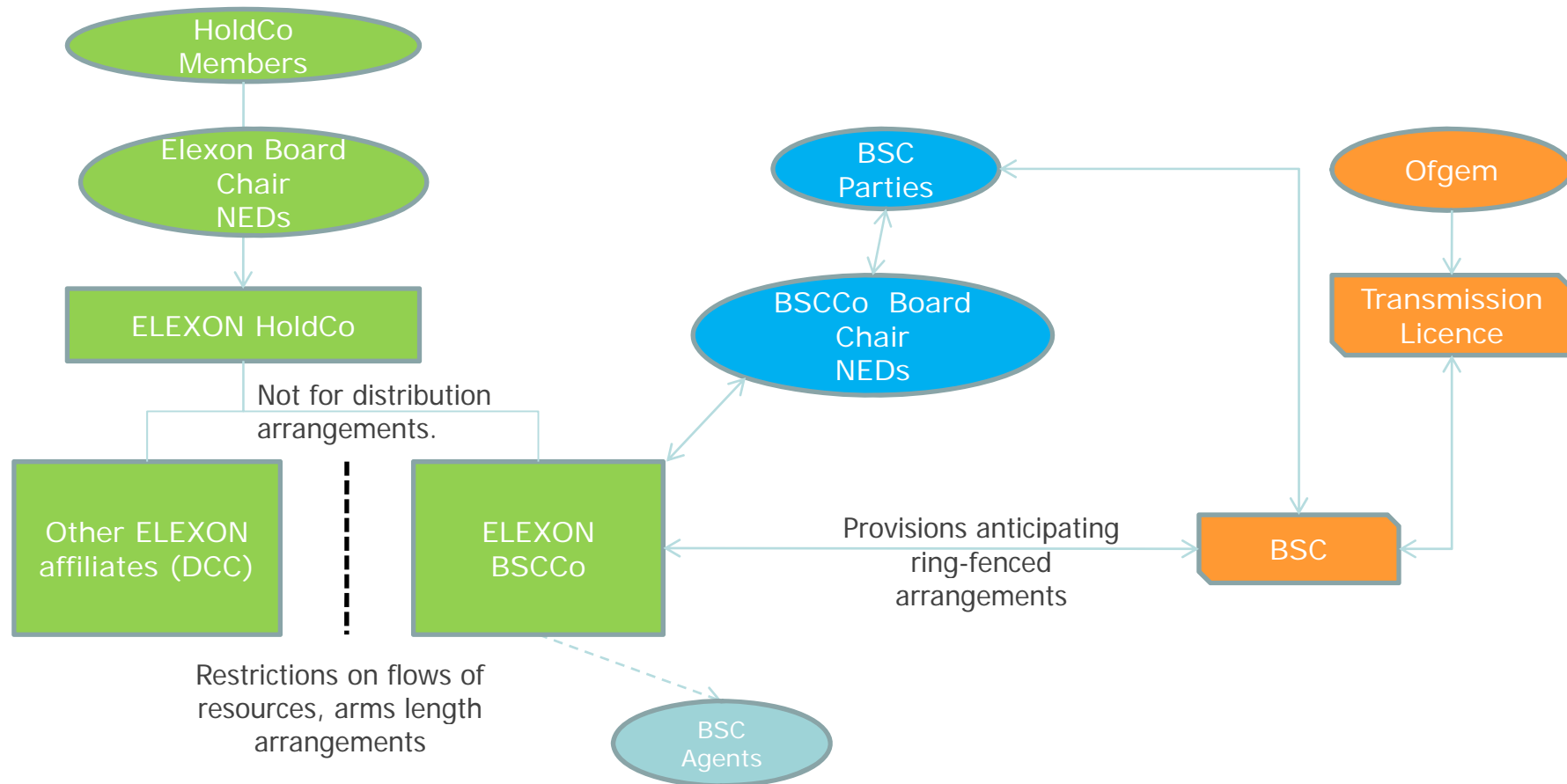
## Elements of models (1) Current arrangements



## Elements of models (2) Contract model



## Elements of models (3) Subsidiary model



## Key elements of implementation

Element	Contract	Subsidiary
BSC modifications	✓	✓
Service contract	✓	x
Ring-fencing arrangements	x	✓
Due diligence and impact on assets, staff, IPR	✓	✓
Pensions negotiations	✓	✓
Establishment of new entities	✓	✓
Start-up costs recovery mechanism	✓	✓
NGET licence and shareholder modifications	x	✓
Composition and responsibilities of new Boards	✓	✓
Capital raising for new entities	✓	✓

## Establishing tasks and timeframes

*“What is required at a minimum to enable Elexon to bid for DCC?”*

- Equity partner(s) for DCC.
- In turn requires:
  - Regulatory certainty on which model
  - Implementation structures in place
  - Roadmap and timetable compatible with DECC’s timetable
  - Heads of terms for contract/ ring-fencing terms for BSCCo and any other Elexon activities
- Resourcing for start-up phase
- Sponsor for BSC modifications to unlock vires

## Detailed tasks for implementation

Ofgem's role is to assist industry/Elexon implement change in the required timeframe, and ultimately to ensure change is in the interests of consumers.

In this role Ofgem requires:

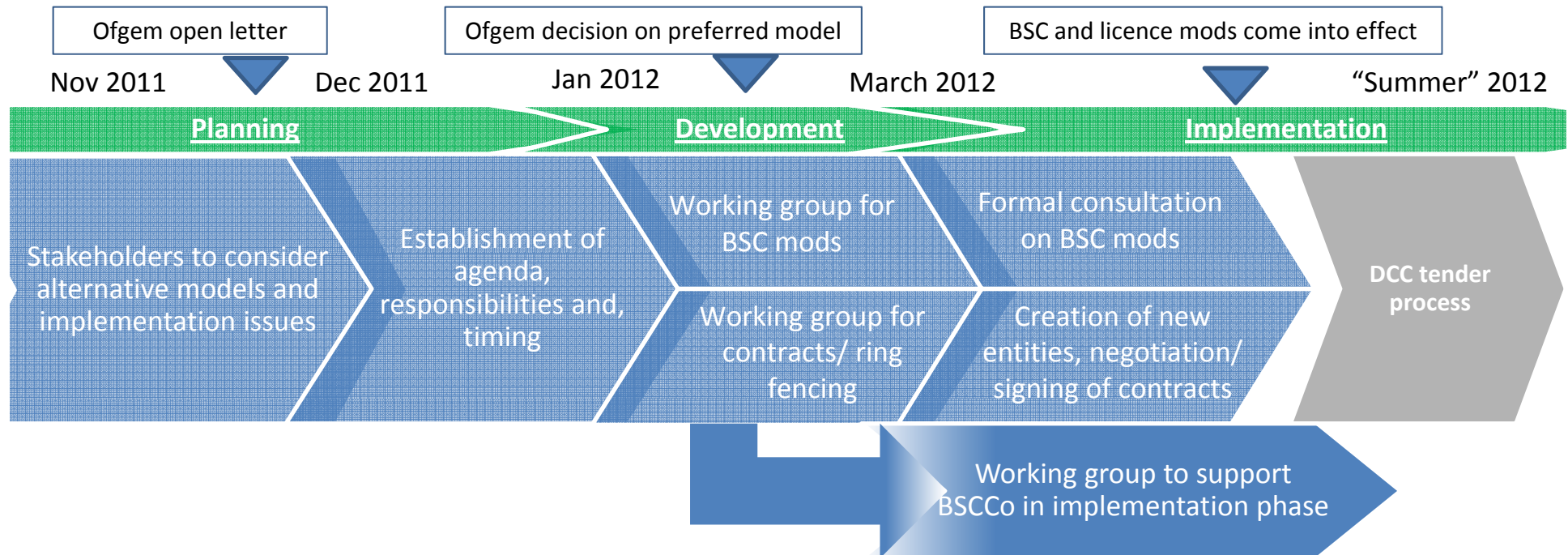
- further details on key elements of each model to inform its decision on preferred model
- development of robust implementation plans for both models to be ready in anticipation of decision
  - Elexon has proposed a workplan to prepare implementation of both models and submit deliverables to Ofgem by 6 January
  - Need to establish a process to involving all stakeholders, particularly BSC Parties
  - In parallel, Ofgem will continue to develop its own thinking on BSC modifications and acceptable content of ring-fencing/contract arrangements

## Detailed tasks for implementation

Elexon's offer for next stage of work:

- Appropriate that Elexon is major contributor to implementation, however requires Ofgem and stakeholder buy-in.
- Modifications to unlock vires will only get industry/ Ofgem support where we are satisfied that preparatory work is in the interests of BSC Parties and consumers.
- Suggest establishment of working groups to consider and approve Elexon's work on:
  - Development of code/ licence modifications
  - Ring-fencing provisions
  - Contract provisions
  - Management of other implementation issues





- Elexon/ Ofgem likely to provide more leadership and output in early phases
- Key decision points for:
  - Ofgem's preferred model
  - Approval of heads of terms in contract/ ring-fencing
  - BSC modifications

## Next steps

- From today – agreement on establishment of working groups
  - Composition of each group
  - Consideration of scope of work
  - Confirm deliverables for Elexon and other parties
- 6 January 2012 – submissions on Ofgem open letter due
- Late Jan/ early Feb – Ofgem decision on preferred model, including detailed implementation timetable
- Late Feb – settlement of heads of terms for contract/ ring-fencing terms
- From March – detailed implementation



*ofgem*

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## Next steps - key implementation areas

### BSC modifications:

- Establish likely sponsors of BSC modifications – these are required under either approach
- Likely modifications:
  - Allow BSCCo to dispose of/ lease assets
  - Permit other entities to access BSCCo systems and other intellectual property
  - Allow contractors to act on BSCCo's behalf
  - Expressly prohibit cross subsidies between BSCCo and affiliates, mandatory procedures for sharing of common costs
  - Bolstering reporting requirements for ring-fencing compliance monitoring

## Next steps - key implementation areas

### Service contract and ring-fencing specifications:

- Identify obligations of Elexon and BSCCo
- Which BSC obligations (to BSC Parties) will be retained by BSCCo, and which outsourced/ transferred
  - allocation or access to staff, assets, IPR
  - Identification of service lines
  - Pricing / cost recovery arrangements
- Treatment of existing in-house/ outsourced services
- Life of contract / arrangements and provisions for review
- Penalties/ incentives around performance

## Next steps - key implementation areas

- General implementation and other matters
  - Development of timelines and coordination of involved stakeholders
  - Start-up resourcing
    - How will initial start up/ negotiations be resourced?
    - Committee drawn from BSC parties?
    - Up front allowance in contract or additional funding from BSCCo?
    - Should these be presented as part of BSCCo costs during mod assessment?
    - What type of expertise is required?
  - Exploring equity raising for new entities
  - Composition/ duties of newly created and existing boards