



Making a positive difference
for energy consumers

The Balancing and Settlement
Code (BSC) Panel, Elexon Board
and all other interested parties

Direct Dial: 020 7901 7165
Email: Hannah.nixon@ofgem.gov.uk

Date: 16 October 2013

Dear Colleague

Review of Elexon's governance

I am writing to you in relation to the review of Elexon's governance that the Balancing and Settlement Code (BSC) Panel and Elexon Board commissioned earlier this year. We note that the recommendations from the review have now been published.¹

The review identified some potentially significant problems with the current governance arrangements. This letter sets out some initial Ofgem views on the review's findings, to aid industry in developing options for change (if appropriate) that are in the best interests of consumers.

Background

The BSC is a requirement of National Grid's (NGET) electricity transmission licence standard licence condition (SLC) C3.² SLC C3 sets out the scope of the balancing and settlement functions to be covered by the BSC.

Elexon is the BSC Company (BSCCo), responsible for administering the BSC arrangements. Since late 2010, Elexon has been exploring potential opportunities to take on roles outside of its current BSC remit. Ofgem has stated that there may be benefits to Elexon expanding, subject to our four conditions being met.³ The aim of our conditions is to protect BSC Parties and ultimately consumers.

Elexon, industry and Ofgem have explored a number of potential models to enable Elexon to expand its role. The process issues raised by industry in the course of the development of a BSC modification proposal seeking to enable Elexon to bid in DECC's smart metering tender exercise earlier this year,⁴ triggered the BSC Panel and Elexon's Board to commission an independent review of Elexon's governance.

¹ <http://www.elexon.co.uk/wp-content/uploads/2013/07/The-Governance-of-ELEXON-Final-Report.pdf>

² <https://epr.ofgem.gov.uk/Content/Documents/Electricity%20transmission%20full%20set%20of%20consolidated%20standard%20licence%20conditions%20-%20Current%20Version.pdf>

³ Our four conditions are set out in an open letter issued in April 2012 (<https://www.ofgem.gov.uk/ofgem-publications/61697/elexon-expansion-way-forward-letter-300412.pdf>) and are as follows: (i) BSC Parties should benefit from any diversification; (ii) The arrangements should not place disproportionate risk on BSC Parties; (iii) Standards of service under the BSC should be maintained; and (iv) Elexon's BSC role should not give it any undue competitive advantage in a contestable activity.

⁴ <http://www.elexon.co.uk/mod-proposal/p289/>

The review has identified a number of problems with the current arrangements and set out recommendations for change including the following:⁵

- A **single Board** to replace the existing Board and Panel
- Board members should be appointed and at least half should be independent, and the Board should follow the **UK Corporate Governance Code**
- The modifications process should be managed by a **Modifications Committee** reporting to the (new) Board; the processes should remain as they currently are, though with some improvements
- **Consumer Futures** should have additional funding for its BSC activities; it should be able to make representations to the Modifications Committee – but not vote on modifications
- BSC parties should be able to **dismiss Board members** (with voting rights based on annual funding shares)
- BSC parties should also have a say in **Ellexon expanding its role**, though any BSC modifications (which would be required) would still be subject to Ofgem approval
- Ofgem should consider removing the **licence restriction** to enable the BSCCo to undertake activities outside the BSC
- Ofgem should **clarify the condition that BSC parties should benefit from any Ellexon expansion** – or ultimately drop the four conditions as these are matters the BSCCo Board should in any case properly take into account.

Our views

We note the issues that the review has highlighted and urge the BSC Panel and Ellexon Board to work with industry to develop options to address these in a timely way.

We understand that a key aim of the recommendations is to improve Ellexon's accountability to industry. We share the view that any changes must deliver greater accountability, improved governance and more effective decision-making. For Ofgem, the key test will be whether the detailed arrangements operate in the best interests of consumers.

We strongly agree with the review's conclusion that the voice of the consumer should be heard. We note that the recommendations are said to be aimed at making that voice clearer and better informed. We would want strong evidence that the impact on consumers will be appropriately identified and considered, and that consumer bodies will have an appropriate ongoing role.

We consider that work on any detailed proposals should seek to ensure that the arrangements operate in the best interests of consumers and continue to involve and take account of the interests of smaller industry participants.

The recommendations are at a high level; more work is needed to consider these recommendations and develop potential code changes if appropriate (and any such changes would be required to be approved by Ofgem). We urge the BSC Panel, NGET and industry to take steps to develop options for change; we are committed to engaging with industry to deliver beneficial change.

Potential transmission licence change

The review recommends Ofgem should consider a change to NGET's transmission licence, potentially along the lines of the change that we suggested in April 2012 may be an appropriate model for industry to explore.⁶ That is, a 'limited expansion' model.

⁵ This is a summary intended to give an overview of some of the report's recommendations; it is not exhaustive and interested parties should refer to the full report for a complete list of the recommendations.

⁶ <https://www.ofgem.gov.uk/ofgem-publications/61697/ellexon-expansion-way-forward-letter-300412.pdf>

Whilst no such limited expansion model has been developed by industry since our April 2012 letter, we continue to see potential merit in this approach. We anticipate a limited expansion model could be given effect through a change to NGET's transmission licence, with any changes in role requiring code modification approval (on a case by case basis). Any such change would need to demonstrate the BSC objectives are better facilitated and, under the current arrangements, would have to satisfy our four conditions (which we continue to consider important for protecting consumers).

Next steps

We expect industry to develop and deliver options aimed at addressing, where appropriate, the problems identified in the review of Elexon's governance. In parallel, we propose to engage in discussions with NGET and other interested parties regarding a potential change to the electricity transmission licence.

Yours sincerely

Hannah Nixon

Senior Partner, Smarter Grids and Governance: Distribution