

Modification proposal:	Balancing and Settlement Code (BSC) P303: Amendments to the provisions for BSCCo directors		
Decision:	The Authority ¹ directs that modification P303 Alternative be made ²		
Target audience:	National Grid Electricity Transmission Plc (NGET), Parties to the BSC and other interested parties		
Date of publication:	13 November 2014	Implementation Date:	28 November 2014

Background

The Balancing and Settlement Code Company's (BSCCo) principal role is to provide and procure facilities, resources and services required for the proper, effective and efficient implementation of the BSC.³ In September 2012 we approved BSC modification P281 Alternative which established new arrangements for the BSCCo Board of Directors.⁴

The original composition of the Board⁵ was an independent Chairman, two directors who were also BSC Panel⁶ members (elected to the Board by the Panel) and two additional directors⁷ who could be appointed by the Chairman after consultation with the Panel. P281 Alternative changed the Board's composition to an independent Chairman, a majority⁸ of directors who have relevant electricity industry experience,⁹ and a minimum of two 'industry independent' directors.¹⁰ Industry independent is defined in the BSC as being where an individual (or a related person to that individual) has not been a Panel Member, employee, director or representative of any BSC Party or class of Parties (including trade associations and other industry groups), or any BSC Agent or other agent of the BSCCo, in the five years prior to their appointment.

P281 Alternative also revised the director appointment and removal processes. However, it did not consider the principles or process for determining remuneration for BSCCo directors. The provisions for remuneration that related to the original Board composition therefore remain. Consequently, industry independent directors are entitled to receive remuneration as may be determined by the Chairman (in consultation with the BSC Panel),¹¹ while directors with relevant electricity industry experience ('industry' directors) are not entitled to receive remuneration.

The modification proposal

P303 was raised by Utilita (the proposer). It seeks to ensure that all BSCCo directors are entitled to receive remuneration and benefits as may be determined by the Chairman after consultation with the BSC Panel. It also seeks to amend the criteria for industry

¹ The terms 'the Authority', 'Ofgem' and 'we' are used interchangeably in this document. Ofgem is the Office of the Gas and Electricity Markets Authority.

² This document is notice of the reasons for this decision as required by section 49A of the Electricity Act 1989.

³ BSC Section C 1.2.1. The BSCCo is Elexon Limited as defined in BSC Annex X-1 of the BSC.

⁴ P281 decision letter: <https://www.ofgem.gov.uk/publications-and-updates/balancing-and-settlement-code-bsc-p281-change-balancing-and-settlement-code-company-bscco-board-directors-chairman>

⁵ As set out during the establishment of the New Electricity Trading Arrangements (NETA): <http://webarchive.nationalarchives.gov.uk/20130807095857/http://www.ofgem.gov.uk/Licensing/ad/Document%20s1/The%20New%20Electricity%20Trading%20Arrangements%2029%2010.pdf>

⁶ The BSC Panel is established and constituted pursuant to and in accordance with Section B of the BSC.

⁷ Who may or may not be BSC Panel members.

⁸ Not including the Chairman.

⁹ BSC Section C 4.1.3 (b).

¹⁰ BSC Section C 4.1.3 (c). The size and composition of the Board is determined by a Nomination Committee, in accordance with these rules.

¹¹ BSC Section C 4.4.2.

independent directors such that they must still be independent of the industry,¹² however, the requirement of a five year gap would be removed. The proposer believes that the current arrangements restrict the pool of candidates for the BSCCo Board, and that this modification would better facilitate BSC objective (d).¹³ The proposer argues that the provision of remuneration would ensure that all directors are able to properly devote the time and commitment required to fulfil their roles, and that both elements of the proposal would increase the pool of potential candidates, therefore improving the functioning of the Board.

The P303 workgroup put forward an alternative solution (P303 Alternative) which proposes the same modification to the criteria for industry independent directors as the original solution (P303 Proposed). However, it does not propose any amendment to the provisions for director remuneration.

BSC Panel recommendation

At the 9 October BSC Panel meeting, a majority of the BSC Panel considered that P303 Proposed would not better facilitate the BSC objectives and the Panel therefore did not recommend its approval.

A majority of the BSC Panel considered that P303 Alternative would better facilitate BSC objective (d), and the Panel therefore recommended that P303 Alternative should be approved.

Our decision

We have considered the issues raised by the modification proposal and the Final Modification Report (FMR) dated 9 October 2014.¹⁴ We have considered and taken into account the responses to Elexon's¹⁵ consultations which are attached to the FMR. We have concluded that:

1. implementation of P303 Proposed will not better facilitate the achievement of the applicable objectives of the BSC;¹⁶
2. implementation of P303 Alternative will better facilitate the achievement of the applicable objectives of the BSC; and
3. directing that the Alternative modification be made is consistent with the Authority's principal objective and statutory duties.¹⁷

Reasons for our decision

We consider that P303 Proposed and P303 Alternative impact on BSC objective (d) for the reasons set out below and have no impact on the other BSC objectives.

¹² Not currently be a Panel member, employee, director or representative of any BSC Party or class of Parties, or any BSC Agent or other agent of the BSCCo.

¹³ Standard Condition C3 3(d) of NGET's Transmission Licence: 'promoting efficiency in the implementation and administration of the balancing and settlement arrangements...'

¹⁴ BSC modification proposals, modification reports and representations can be viewed on the Elexon website at www.elexon.com

¹⁵ The role and powers, functions and responsibilities of Elexon are set out in Section C of the BSC.

¹⁶ As set out in Standard Condition C3(3) of NGET's Transmission Licence, see:

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

¹⁷ The Authority's statutory duties are wider than matters which the Panel must take into consideration and are detailed mainly in the Electricity Act 1989.

BSC objective (d) - promoting efficiency in the implementation and administration of the balancing and settlement arrangements

Five year gap for industry independent directors

We commented in our decision on P281 that we considered the arrangements for industry independent directors could be dealt with under the Nomination Committee's Terms of Reference as a matter of best practice, allowing for the specific needs of the Board to be taken into account. We agree therefore with the majority view of the BSC Panel that, by removing the five year gap from the definition of industry independent director, both P303 Proposed and P303 Alternative would introduce beneficial flexibility into the arrangements, increasing the potential pool of industry independent Board candidates. We agree with the P303 workgroup's view that a five year gap since working in the industry is arbitrary and that it is unnecessarily prescriptive. We consider that removing this as a codified requirement will improve efficiency. For example, if an exceptional candidate for the Board had just under a five year period working outside the industry, they would be precluded by the current arrangements which do not allow the Nomination Committee to exercise judgement on this.

We also note that the BSCCo Board arrangements aim to reflect accepted UK corporate governance standards (so far as relevant).¹⁸ By providing discretion for the Nomination Committee to judge candidate suitability on a case-by-case basis, while taking account of best practice guidelines,¹⁹ this will better enable directors to be appointed with specific, required skills, who at the same time bring an impartial perspective on stakeholder needs. This in turn will improve efficiency in the administration of the BSC arrangements.

We further agree with the workgroup that, following implementation of this modification, the Nomination Committee Terms of Reference should provide guidance on the minimum gap that is desirable between an individual having worked in the industry and becoming an industry independent director. While this is outside the scope of the modification, we nonetheless consider this is an important element to be taken forward by the BSC Panel, who should ensure that robust Terms of Reference are in place in order that the arrangements work effectively and as intended. For example, ensuring that a distinction between 'industry' and 'industry independent' directors is maintained as intended by the BSC.

Remuneration of industry directors

While we consider that the arrangements described above improve efficiency, we do not consider it has been demonstrated that P303 Proposed, which proposes to introduce remuneration for industry directors, would better facilitate this objective overall. This is because the FMR and responses to the industry consultations do not demonstrate that there is currently a case for remunerating industry directors, and doing so without clear justification may unnecessarily increase BSC costs. It is noted in the FMR that in the last recruitment process there were 15 applications for industry director positions, compared to 400 for industry independent positions. The workgroup questioned the validity of this comparison, stating that more than 15 candidates had enquired about the positions. Furthermore it could be anticipated that there will be asymmetry in the number of

¹⁸ Under P281 Alternative the Board appointment process aimed to reflect UK corporate governance standards, and the Nomination Committee Terms of Reference require that consideration is given, amongst other things, to the provisions of the UK Corporate Governance Code: http://www.elexon.co.uk/wp-content/uploads/2013/06/Nomination-Committee_Terms-Of-Reference_1.0.pdf

¹⁹ The UK Corporate Governance Code sets out that for directors to be characterised as 'independent' they should usually not have had a material business relationship with the company within the last three years. UK Corporate Governance Code B.1.1: <https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/UK-Corporate-Governance-Code-2014.pdf>

applicants for the different Board positions, regardless of remuneration, owing to the non-industry pool naturally being larger.

We recognise that remuneration may assist smaller participants in participating on the BSCCo Board. However, we also note that an independent supplier who responded to the consultation considered that remuneration would not help smaller suppliers to undertake a BSCCo Board position, as it is the time/resource commitment required that is likely to be prohibitive. We also note the comments put forward by the BSCCo Board, that the UK Corporate Governance Code suggests levels of remuneration for non-executive directors should reflect the time commitment and responsibilities of the role,²⁰ however there is also guidance on how such remuneration should be determined and this has not been considered by this proposal.

As a defect in this area has not been clearly identified, and the P281 arrangements remain relatively new,²¹ it is not clear at this stage that this proposal would better facilitate the applicable objectives. Furthermore, the Board and Panel's broader Elexon Governance Review²² has not yet concluded, which may have wider implications for the Board. We would suggest that any further consideration of this issue is undertaken in light of the outcomes of the Elexon Governance Review, and that any future modification that may be proposed in this area could more closely examine the costs and benefits of industry director remuneration and the principles/process for remuneration levels being determined.

Decision notice

In accordance with Standard Condition C3 of NGET's Transmission Licence, the Authority hereby directs that modification proposal BSC P303 Alternative: *Amendments to the provisions for BSCCo directors* be made.

Declan Tomany

Associate Partner, Legal – Smarter Grids and Governance

Signed on behalf of the Authority and authorised for that purpose

²⁰ UK Corporate Governance Code D.1.3: <https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/UK-Corporate-Governance-Code-2014.pdf>

²¹ One industry appointment process has been undertaken under the current arrangements.

²² The BSCCo Board and BSC Panel are currently considering the findings of an independent review of Elexon's governance commissioned in 2013: <http://www.elexon.co.uk/news/bill-knights-elexon-governance-review-published/>