ELEXON

Stage 04: Draft Modification Report

What stage is this document in the process?

01 Initial Written Assessment

02 Definition Procedure

03 Assessment Procedure

04 Report Phase

Report Phase consultation closes on 2 August 2012

P281: Change of BSCCo Board of Directors & Chairman

P281 seeks to change the make-up of the Balancing and Settlement Code Company (BSCCo) Board of Directors, to:

- Allow BSC Parties a more active say in the management and oversight of BSCCo; and
- Ensure the appropriate separation of the BSCCo Board from the management of ELEXON Limited, should ELEXON be permitted to diversify its activities.

The Workgroup has developed an Alternative solution to address the issues identified under P281 by introducing provisions that promote corporate governance best practices.

Initially, the Panel recommends:

Approval of the P281 Alternative Modification

High Impact:

BSCCo (ELEXON) and BSC Parties

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About this document:

This is the P281 Draft Modification Report, setting out the Panel's initial views on P281 for industry consultation. ELEXON will update this report following the consultation and present it to the Panel on 9 August 2012. The Panel will consider the responses received and updated recommendations and agree a final view on whether or not this change should be made.

Any questions?

Contact:
Dean Riddell

dean.riddell@elexon.co.uk

02073804366

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1 Summary

Why Change?

There is concern that the current BSCCo Board arrangements do not promote the appointment of a Board which Parties (who fund the BSC arrangements) can be confident will understand and fully consider the implications of its decisions for the wider industry. There is also a concern that the process of Board appointments are not sufficiently transparent and do not provide for enough input from Parties.

Proposed Solution

Parties that operate as Generators and Suppliers would be split into 4 constituencies (Large Supplier, Large Generator, Small Supplier, Small Generator). Each constituency would elect 1 member to the Board. The result is a BSCCo Board consisting of a Chairman and 4 industry elected members.

Alternative Solution

The size of the Board would be determined by a Nomination Committee, with the restriction that, excluding the Chairman, the majority of Directors shall have electricity industry experience. The Nomination Committee would, subject to Terms of Reference created by the Board and approved by the Panel, select candidates for appointment to the Board. The Panel can vote not to ratify appointments in certain circumstances. The Alternative is intended to provide a robust and transparent process that is in line with accepted best practice and incorporates Party input and Panel oversight.

Implementation, Impacts & Costs

The Code changes for both the Proposed and Alternative Modification would be implemented 10 Working Days following approval by the Authority.

For the Proposed, initial elections would be conducted such that new, elected, industry Board members are appointed by three months after the implementation date.

For the Alternative, once the Code provisions are in place the Nomination Committee would appoint new Board members in accordance with its Terms of Reference and the P281 Alternative provisions, with regard for the need to preserve continuity, experience and expertise. Transitional provisions are included to assist the implementation.

Besides increased participation in the process of Board appointments, implementation of either the Proposed or Alternative would have minimal impact on Parties.

The Case for Change

The Panel was concerned that election by constituencies of Parties would not be an effective process to appoint Board members that are required to act independently.

The Panel believed that the Alternative is in line with best practice processes and would deliver the increased transparency and greater opportunity for Party input sought by P281.

Recommendations

The Panel's initial recommendation is that:

- P281 Proposed should not be approved; and
- P281 Alternative should be approved.

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The Balancing and Settlement Code Company

BSC Section C sets out the powers, functions, responsibilities and constitution of BSCCo, whose principle role is to give proper, effective and efficient implementation of the BSC. BSC Section C1.2.2 currently precludes BSCCo from undertaking any business or activity which is not provided for in the BSC.

Current constitution of the BSCCo Board

BSC Section C4 sets out the existing constitution of the BSCCo Board of Directors ('the Board'). Under these provisions, the Board comprises five Directors as follows:

- **The Board Chairman**, who is the BSC Panel Chairman appointed by Ofgem. The Chairman holds office for 3 years, although they may be reappointed by Ofgem following the expiry of this term of office.
- **Two (non-executive) Industry Directors**, who are Industry Panel Members nominated to the Board by the BSC Panel. The Industry Directors hold office for the 2 year term of their Panel Membership, although they may be reappointed by the Panel following the expiry of this term of office.
- **Two (non-executive, non-industry) Directors**, who are nominated by the Chairman after consultation with the Panel. These Directors hold office for 2 years, but may be reappointed by the Chairman following the expiry of this term of office.

All five Directors are indemnified by BSCCo for all liabilities incurred in their role as Directors (C4.5), and are entitled to be reimbursed by BSCCo for their reasonable costs and expenses (C4.4). The two non-industry, non-executive Directors are also entitled to receive such additional remuneration and benefits as may be determined by the Chairman after consultation with the Panel (C4.4.2). None of the others are entitled to receive any additional remuneration or benefits in their capacity as Directors (C4.4.3).[1]

All of the five Directors are able to vote on Board business. BSC Section C4.7 requires that Board proceedings are conducted and governed in accordance with the Articles of Association of BSCCo, which include provisions relating to the appointment and removal of Directors. BSCCo's Articles of Association are based on the Companies Act 1985 Table A Articles[2], and are publicly available through Companies House.

The Board delegates the day-to-day conduct of BSCCo to the Chief Executive (C4.6.4), supported by the BSCCo Executive team. The Chief Executive of BSCCo is not a member of the Board, although they are entitled to attend and speak (but not vote at) Board meetings in accordance with BSC Section C4.6.3. Members of the BSCCo Executive team may also attend Board meetings, but are not Board members and cannot vote. The Chairman is not a member of the Executive team.

Role of the BSCCo Board

Under the BSC, the Board is responsible for:

- Appointing the BSCCo Chief Executive after consultation with the Panel (C4.6); and

More information on the BSCCo Board

BSC Section C sets out the current BSC rules regarding the Board's constitution.

Details of current BSCCo Board members and the BSCCo Executive team members can be found here.

[1] The Chairman is remunerated as the BSC Panel Chairman under BSC Section B2.1, rather than as the BSCCo Board Chairman. This remuneration is determined by Ofgem in consultation with the Panel (B2.11).

[2] http://www.companieshouse.gov.uk/about/tableA/comm1Aug85CoRegulations1985_P1.pdf

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- Approving BSCCo's Annual Budget following consultation with BSC Parties and other interested parties (C6.4). Note the Panel, not the Board, approves BSCCo's annual Business Strategy following consultation with BSC Parties and other interested parties.

In addition to its specific BSC requirements, the Board has the wider role of directing BSCCo. This role includes responsibility for monitoring BSCCo's performance, scrutiny of BSCCo's finances and ensuring that BSCCo operations are subject to effective cost-control. The manner in which the Board fulfils its role is not prescribed in the BSC. Certain requirements (e.g. regarding quorum at meetings) are included in BSCCo's Articles of Association. However, the way the Board conducts its business is not prescribed.

Rationale for current Board constitution

Page 174 of 'The New Electricity Trading Arrangements: Ofgem/DTI Conclusions Document' (October 1999) summarises the conclusions of Ofgem and the Department of Trade and Industry (DTI) on the constitution of the BSCCo Board as follows:

> *"**BSC Board***
>
> *The Chairman and the Panel will select four persons to become non-executive directors of the BSCCo and to form the BSCCo Board. Ofgem/DTI feel that the Board should be smaller in size than the Panel, as a smaller body is better able to exercise the required level of scrutiny and control of the BSCCo. Two of the directors will be drawn from the industry members of the Panel. The remaining two directors could be selected either from within the remaining Panel members or from outside, if particular skills were required on the Board that were not present among the Panel membership. For example, the Chairman might want to have accounting and IT advice available to him on the Board. The Board responsibilities will include the approval of the BSCCo business plan and budget and the monitoring of performance. The fact that the Board will be non-executive, and include representatives of those paying BSCCo fees, should reassure participants that there will be sufficient transparency, scrutiny and control of costs."*

What is the Issue?

The Proposer of P281 (E.ON Energy Solutions Ltd) believes that the current BSCCo Board arrangements can allow the non-industry, non-executive Directors and the Chairman to carry Board decisions against the will of the non-executive Industry Directors. The Proposer argues that this means ELEXON resources can be used, budgets set and expenditure incurred even though such decisions may not be supported by BSC Parties and other affected stakeholders.

ELEXON has expressed its desire to diversify and extend its activities outside the administration of the BSC, to take advantage of its skills and expertise in the development of market arrangements. The Proposer supports ELEXON's aspirations in this regard and has confidence that ELEXON is well placed to make a valuable contribution to these market developments.

The Proposer considers that, should ELEXON be permitted to diversify its activities beyond the BSC, it will become even more important to establish a BSCCo Board that is able to safeguard the interests of BSC Parties (who fund the BSC arrangements) from any potential risk or conflict of interest arising from these other non-BSC commercial activities. The Proposer believes that the reform of the BSCCo Board is thus an essential component of the changes required to enable ELEXON to diversify its activities. The Proposer argues that such reform will help ensure the appropriate separation of the BSCCo Board from the management of ELEXON.

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3 Proposed Solution

This section sets out the P281 Proposed Modification solution. P281 does not seek to amend the function of the Board, only its constitution.

Board Constitution

Under the Proposed Modification the BSCCo Board would consist of the Chairman and 4 independent, non-executive Directors. The 4 independent, non-executive Directors would be elected by 4 constituencies of Parties that operate as Generators and Suppliers (Large Supplier, Large Generator, Small Supplier, Small Generator). Each constituency would elect 1 Board member.

The result is a BSCCo Board consisting of a Chairman and 4 industry elected members as follows:

- Large Supplier Board Member;
- Small Supplier Board Member;
- Large Generator Board Member; and
- Small Generator Board Member.

The independent industry-elected Board members ('industry members') would act independently and in the interests of BSCCo and the delivery of the BSC. Though elected by 'constituencies' of Generators or Suppliers, the industry members would not represent the interests of the constituency that elected them. Rather it is envisaged that the elections process will ensure that the industry members have experience such that they will understand the implication of Board decisions for Parties that fund the BSC arrangements.

The industry members would serve three year terms and would all carry equal weight in Board votes.

Panel members are eligible to be elected as BSCCo Board industry members. However, there would not be a requirement for industry Panel members to become Board members as well; industry Panel and Board membership would be completely independent of one another.

Board Elections

Constituencies

The Proposed solution has 4 electoral constituencies (Large Supplier, Large Generator, Small Supplier, Small Generator). The Proposer believed that these constituencies would ensure that the views of a variety types and sizes of the BSC Parties that predominantly fund the BSC (i.e. generators and Suppliers, as Trading Parties that are exposed to the net main funding share) are taken into account in the appointment of Board members. The Workgroup accepted the rationale that the views of generators and Suppliers should be prioritised since these are the Parties that primarily fund the BSC arrangements.

The Proposer therefore confirmed that any Party/TPG that is neither a Supplier nor a generator would not be able to participate in the elections proposed by P281.

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When determining membership of constituencies Parties would be considered in terms of Trading Party Groups (TPG). As part of the BSCCo Board elections a Party or TPG can:

- Qualify for membership of up to two constituencies based on its activities and market share (i.e. it can be a Large or Small generator and also Large or Small Supplier);
- Vote in elections for any constituency for which it qualifies; and
- Nominate a candidate in only one constituency for which it is qualified for each two year round of elections (i.e. due to the staggering of elections the replacement of all industry Board members spans two years, but this is considered a single 'bloc' of elections for the purposes of Parties' ability to nominate Board members).

Voting

For each constituency in which it qualifies a Party or TPG may have one vote. I.e. a TGP which qualifies as both a small Supplier and a large generator would receive one vote in the small Supplier election and one vote in the large generator election.

Large or Small Generator/Supplier

Whether generators and/or Suppliers are considered large or small will be determined by the average percentage share of Parties/TPGs energy volumes. Any generator or Supplier with less than 5% average percentage energy volumes (SVA volumes considered to denote a Part/TPG as eligible for Supplier and CVA volumes considered to denote a TPG as eligible for generator constituency) would be considered eligible to vote or nominate as a small generator and/or supplier.

Frequency of elections

In order to ensure that the entirety of the Board could not be changed all at once, the election of industry Board members should be staggered such that the election of the Supplier members (Large and Small) takes place in a different year to the election of generator members (Large and Small).

In line with the agreed three year term of industry Board members, each constituency industry Board member's position would be subject to re-election at three year intervals. Since upon implementation of P281 all industry Board members would need to be elected in the same year, the staggering would be achieved by one set of industry members serving a truncated initial term of two years. This is shown in the table below, and in this illustration the Supplier members serve a short first term. The BSCCo Board would decide whether it is Suppliers or generators who serve the initial truncated term. Note that Panel elections occur every two years, so the staggered three year Board elections process would mean that elections of some sort would occur more frequently than at present.

Year	1	2	3	4	5	6	7	8	9	10
Panel Election	X	No elections	X		X		X	No elections	X	
Board Election (Suppliers)	X		X			X			X	
Board Election (Generators)	X			X			X			X

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Mid-term replacement of Board members

In the case of a Board member leaving the Board part-way through their term it would be up to the discretion of the BSCCo Chairman to decide how to address the situation, taking into consideration the remaining Board and the current point in the Board election cycle (i.e. the staggered three year cycle) and the time till the next Panel elections. So the Chairman could determine, depending on the amount of time until the next election and the constitution of the remaining board:

- Not to replace the Board member before the next relevant constituency election;
- To appoint an interim Board member (i.e. without an election) to serve until the next relevant constituency election. This Board member should, in the first instance, be one of the candidates in the same constituency from the previous election as the outgoing Board member, if the Chairman believes one of the previous candidates is suitable and providing the chosen replacement is willing to be appointed to the Board; or
- To hold an ad hoc constituency election at the same time as a scheduled election (Board or Panel) to appoint a Board member under the next scheduled relevant constituency election.

Remuneration of Board Members

The 4 industry members of the Board would not receive a fee for their Board services, only payment for expenses incurred in the course of service on the Board.

Board Chairman

Following Ofgem's Code Governance Review the Transmission Licence was updated to reflect that the Panel would select an independent Chairman, of both the BSCCo Board and BSC Panel, whose appointment is ratified by the Authority.

However, the BSC does not currently reflect the updated Transmission Licence. Therefore as part of the Proposed Modification the necessary housekeeping changes will be made to align the BSC with the Transmission Licence.

In addition the Proposed Modification would introduce the provision that the Board Chairman would not vote unless the Board is split and a casting vote is therefore required.

Question 4
Do you agree that the Proposed Modification legal text delivers the P281 Proposed solution?

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4 Alternative Solution

The Workgroup considered that the key principles of P281 were increasing the influence of BSC Parties on the constitution of the Board and increasing the Board's transparency and accountability to Parties. However, the Workgroup was concerned that the constituency election process might call into question the impartiality and independence of members voted in by generators and Suppliers, and that the range of Board members' expertise and the ability to select Board members with necessary expertise would be more limited. The Workgroup therefore developed the Alternative solution set out in this section.

Board Constitution

Under the Alternative solution the size of the Board would be determined by a Nomination Committee, with the restriction that, excluding the Chairman, the majority of Directors shall have electricity industry experience. The Workgroup considered that though it was important that the BSCCO Board should not become too large to function effectively this could be achieved via the Nomination Committee's Terms of Reference (ToR).

The Board's Nomination Committee would determine the number of Board members based on the Board's functions and requirements, existing Board composition and the available nominees. This approach more closely aligns with best practice, which puts the onus on the board to manage its own size. The UK Corporate Governance Code states that the 'board should be of sufficient size that the requirements of the business can be met and that changes to the board's composition and that of its committees can be managed without undue disruption, and should not be so large as to be unwieldy'.

Excluding the BSCCo Chair, the majority of the Board must have relevant electricity experience and at least 2 of the Board members should be non-industry, i.e. in the last 5 years they must not have been a Panel member or an employee, director or representative of a Party.

Panel members are eligible to be appointed as BSCCo Board members. The Workgroup considered that acting as both a Panel and a Board member may place a strain on such members, but did not believe it was necessary to prohibit people from acting as both a Panel member and a Board member. Inherently, the Alternative would deliver a separate Panel and Board, though a person filling either role could put themselves forward for consideration for the other role. In the latter circumstance the individual, the nomination committee and Parties can all decide for themselves whether the person's existing role is a positive or negative factor.

Board members would serve terms of up to 2 years in length, in line with the current provisions.

Nomination Committee

A Nomination Committee would be established by the BSCCo Board which would be responsible for determining job descriptions for particular roles, setting out necessary skills and experience (which could include industry experience depending on relevance to the particular role), evaluating candidates and making a recommendation on a candidate to the BSCCo Board.

The means of recruitment for the Board and selection of candidates would be at the discretion of the Nomination Committee, which could select candidates via advertisement, through the use of head-hunters or following submission of an individual to the Nomination Committee by a BSC Party. The Workgroup noted that the use of an open advertisement or head hunters is in line with corporate governance best practice, and

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considered that providing for BSC Parties to nominate potential candidates would deliver the kind of industry involvement sought by P281.

This committee would comprise the BSCCo Chairman, at least one Board member independent of industry, at least one Board member with industry experience and any additional support considered necessary. The Panel also have the ability to appoint a Panel Advisor to assist the Nominations committee in drafting job descriptions and selecting a candidate.

The Nomination Committee's powers and functions would be set out in its Terms of Reference, which would be published in the interests of transparency[3]. These Terms of Reference will be substantially based on the ICSA standard, supplemented with specific details relating to the balance of industry/non-industry members which will be prescribed in the BSC as part of P281 Alternative. An outline of the expected Terms of Reference is included in Appendix 1 of this report, though the Board will produce the actual initial version for the Panel's consideration.

The Terms of Reference therefore should not change much over time, although they will need to be adapted occasionally to keep up to date with best practice. The Panel would be consulted on any material changes and the changes would be published on the BSC website. The Panel would be responsible for ensuring the Terms of Reference follow the specific BSC requirements, and its decision on the Terms of Reference will be binding on the Board.

Panel Ratification and BSC Party input

The Panel has the power to veto the appointment of a candidate to the Board. No other party (i.e. BSC Party or other person/organisation) other than the Panel can veto a candidate, but any BSC Party may inform the Panel of reasons why it believes an appointment should not be ratified.

The BSC requires that an Annual BSC Meeting is held in July each BSC Year (BSC Section B 6.2), where the full BSC Panel, each Director of BSCCo and the Chief Executive of BSCCo are all required to attend. At this meeting any candidate for appointment to the Board would be formally put forward for ratification.

28 days prior to the Annual BSC Meeting, the names of any Board members appointed since the last Annual Meeting will be issued. At least 14 days before the meeting any Party wishing to remove a newly appointed Board member must write to the Panel Secretary outlining why they are requesting the new Board member to be removed. If the Panel agrees with such a request, or as a result of its own considerations, the Panel may veto any candidate by voting not to ratify their appointment. A two thirds majority of Panel members' votes is required to effect the decision to not ratify an appointment.

At the Annual BSC Meeting the Panel would also be able to question the Board and nomination committee about candidates and its selection process. The intent of this process is to give Parties and the Panel transparency and an opportunity to have input into the composition of the Board.

[3] Most companies have similar Nomination Committee Terms of Reference; standard Terms of Reference prepared by ICSA are available, which most companies use as a basis: http://www.icsa.org.uk/assets/files/pdfs/guidance/071013.pdf.

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Mid-term replacement of Board members

In the event of a Board member leaving before the end of their agreed term the Nomination Committee would make an appointment as necessary in accordance with its terms of reference. The appointee would then serve on the Board until the next Annual BSC Meeting, when they would be put forward for formal ratification.

Remuneration of Board Members

Board members would receive payment for expenses incurred in the course of service on the Board in addition to such remuneration and benefits as determined by the Board Chairman after consultation with the Panel.

Board Chairman

Under the Alternative the current Board voting rights would not be amended. Currently the Chairman has an equal vote on the Board but only a casting vote on the Panel, i.e. under the Alternative the Chairman would not be restricted to only a casting vote on the Board. It is normal in Board arrangements for the Chairman to have the same voting rights as the other Board members.

However, in the event of a Board deadlock ELEXON's articles are based on the Companies Act 1985 Table A Articles which allow the chairman a second or casting vote in the event of deadlock.

As under the Proposed Modification, the Alternative will introduce the necessary housekeeping changes to align the BSC with the Transmission Licence provisions on appointment of the BSCCo Board Chairman.

Question 5
Do you agree that the Alternative Modification legal text delivers the P281 Alternative solution?

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5 Impacts & Costs

Impacts and Costs of Proposed Modification

P281 Proposed solution will have minimal impact on Parties and other industry participants. Suppliers and generators would need to nominate Board members for their relevant constituencies and partake in voting once every two years.

There would be associated effort from ELEXON to maintain the constituencies, for small/large generators and suppliers, based on reviewing energy volumes on an annual basis. There would also be effort in coordinating the election process.

The BSC Panel may be called upon to change the threshold of what constitutes a small and large generator and/or Supplier.

Impacts and Costs of Alternative Modification

P281 Alternative will have minimal impact on Parties and other industry participants.

The Board will be responsible for the Nominations Committee and members of the Panel may be called upon to advise the Nominations Committee from time to time.

6 Implementation

Implementation of Proposed Modification

If approved, the Proposed Modification would be implemented such that the initial Supplier and Generator Board elections would be conducted at the same time and aligned with the next feasible Panel Election following implementation. The Code changes to implement the Proposed Modification would be implemented 10 Working Days following approval by the Authority.

In order to implement the First term of either Supplier or Generator members would be a two year term, allowing the subsequent introduction of the three year staggered pattern of Supplier and Generator Board member terms and elections. The BSCCo Board would decide whether it is Suppliers or generators who serve the initial truncated term

Implementation of Alternative Modification

The Code changes to implement the Alternative Modification would be implemented 10 Working Days following approval by the Authority.

Following implementation, the Nominations Committee would begin the process of appointing new Board members in accordance with its Terms of Reference and the P281 Alternative provisions, with regard for the need to preserve some continuity, experience and expertise on the Board.

Question 3

Do you agree with the Panel's recommended Implementation Date for P281 Proposed and Alternative Modifications?

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7 Workgroup Discussions

This section details the Workgroup's discussions that led to the solutions detailed above.

Board constitution

The Workgroup considered that, regardless of agreement over the details in the P281 solution, there appeared to be an appetite among industry participants for some kind of change in the constitution of the Board and the manner in which Board members are appointed. The driver behind this appetite was the findings of Issue 40 and the potential changes in the respective roles and activities of BSCCo and ELEXON.

The Workgroup noted that the BSCCo Board is responsible for ensuring the BSC is delivered efficiently (by ELEXON). The Ofgem representative suggested that P281 Proposed solution seemed to envisage the Board as more of an operational contract manager, which is not really the role of a Board and that in general having the right experience to be a Board member does not necessarily equate to having the right experience to run a company day to day. However, the Workgroup did note that with respect to the BSC there is some (partly intentional) 'blurring' of the responsibilities of the BSCCo Board and the BSC Panel.

A driver behind P281 was to ensure that the majority of the Board understand the priorities and activities of industry stakeholders, and the impacts of decisions upon them. A Workgroup member felt that a source of concern in this area might relate to ELEXON's original investigation into whether it might be possible for it to pursue potential business outside the BSC, and a perception that this was permitted by the Board despite industry Board members' concerns. However, the Workgroup noted that it has been stated publicly that all the Board's decisions in the last year have been unanimous; while particular incidences of Board disagreement could have significance, such situations are clearly not prevalent.

The Workgroup considered whether the aim of P281 could be more effectively or efficiently achieved by some other constitution of Board membership, for instance:

- Adding one further industry member to the existing Board Structure (i.e. three industry and two independent) with the industry members either elected or drawn from the Panel or a mixture; and
- Introducing the Large/Small Supplier/generator Board members as under P281 Proposed but also retaining the existing two independent members (i.e. six Board members overall, besides the Chairman).

However, the Proposer did not decide to change their solution as they believe the present size of the Board is reasonable and that the elections process should deliver the relevant expertise and experience required by the Board (as well as providing assurance to Parties) so there is no need for further, non-elected Board members.

The solution outlined in the proposal called for the Board to be permitted to appoint up to three independent, non-voting experts to support it. However the group agreed that there was nothing preventing the Board from seeking such expertise at present and if such experts would be unable to vote on Board matters there was no benefit to including this restriction (i.e. the Board could enlist further experts as it saw fit so the restriction would be meaningless). The Proposer therefore agreed that this aspect would not be part of the proposed solution.

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Board Elections

Under the Proposed solution constituency election would be required. The Group considered the following on this element of the change.

Large or Small Generator/Supplier

The group considered how membership of a constituency should be determined and what thresholds should be applied to differentiate between Small and Large for the purposes of the P281 provisions, and considered that the criteria applied should consider market share and ideally relate to how Parties funding share contributions are determined. The group considered that either metered energy volumes or generation capacity might be used to distinguish between Large and Small Generators, while differentiation of Large and Small Suppliers could be achieved by considering energy volumes or number of Meters registered to Parties ('MSID count').

The Workgroup discussed the benefits and drawbacks of the various approaches (see table below) and ultimately agreed that it would be better to use energy volumes as criteria for both the generator and Supplier constitutions. The group believed that this approach had the benefit that it is consistent with the basis of the methodology used to calculate funding shares and can be applied for both generator and Supplier constituencies. The Proposer agreed with this rationale and agreed that this approach would be used in the P281 Proposed solution.

	Benefit	Drawback
Generator Volumes	• Consistent - energy volumes can be considered for both generation and Supply • Matches basis of funding share methodology • Represents actual activity and market impact	• May be affected by variations e.g. weather • Relatively backward looking (average over time period to minimise effect of variations) • Affected by netting/embedded generation
Generator installed capacity	• Generation Capacity (GC) can be used • No problem of netting off where Party/TPG operates as both generator and Supplier • Represents maximum impact generator's activity could have on the market • Relatively stable • Up to date snapshot at point in time of nominations	• Differs from funding share methodology • Does not take into account transfer of volumes between Parties via Metered Volume Reallocation Notification (MVRN) • Can be distorted by large declared GCs which are never realised in practice
Supplier volumes	• Consistent - energy volumes can be considered for both generation and Supply • Matches basis of funding share methodology	• May tend to underestimate share of domestic Suppliers (i.e. industrial Suppliers may have large volumes associated with few customers) • May be affected by variations e.g. weather • Relatively backward looking (average over time period to

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		minimise effect of variations) • Affected by netting/embedded generation
Supplier MSID count	• Clear • Relatively stable • Up to date snapshot at point in time of nominations	• Differs from funding share methodology • May tend to underestimate share of industrial Suppliers (i.e. large volumes for few MSIDs)

After agreeing to use energy volumes as a value, the Group considered what threshold might be applied to determine whether a generator or Supplier is considered Large or Small. The group considered analysis of Party/TPGs energy volumes as a percentage of the overall share of SVA volumes (for Suppliers) and CVA volumes (for generators) and considered thresholds for Large Supplier/Generator status of 1%, 5% and 10% share of volumes.

	Average	Large (>1%)	Large (>5%)	Large (>10%)
Supply (SVA vols)	3.704%	9	6	5
Generator (CVA vols)	1.89%	16	7	2

The group agreed that a 5% threshold for both Supply and Generator constituencies would capture the right Party/TPGs as Large. The group considered that a 10% threshold would be too high and would unduly limit qualification as 'Large' while 1% would be too small and would result in organisations being classified as 'Large' where this was clearly not appropriate.

This threshold would be applied upon implementation of P281 Proposed if approved, but under the Proposed solution there is provision for the Panel to review the thresholds as necessary to ensure that they remain relevant and continue to effectively deliver appropriate Large and Small Generator and Supplier constituencies. There is no necessity that the same threshold level is applied for both Suppliers and Generators.

Single or weighted votes

The group considered whether voting in elections should be weighted by market share or whether each Party/TPG should get a single vote in any constituency relevant to it. Consideration was given to voting weighted using the measurement criteria applied to determine constituency membership, albeit using some sort of cap to preclude predominance by a single or very few Parties. This would be consistent with the rationale of apportioning weight in Board elections based on Parties' contribution to the funding of the BSC arrangements.

However, the group and Proposer ultimately agreed that a 'one Party/TPG, one vote' system would be more straightforward and equitable, and also consistent with the approach employed in Panel elections.

The Workgroup considered that the P281 Proposed drafting should include provisions for the case of a tie in Annex C-1 paragraph 4.2, and it would be sensible for this to reflect the approach for used in the case of a tie in Panel elections. The Proposer agreed that this should be included in the solution.

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Panel and Board members

The proposal form suggested that existing Panel members would be eligible to be elected as an industry member and that P281 would not place any restriction on a person fulfilling both a Panel and Board role. The Workgroup did however consider that the present situation where two Board members are drawn from the industry Panel members may cause somewhat of a conflict for those Panel members who also act as Board members, or at least impose restrictions on what they can discuss with the Panel.

Despite these concerns the Proposer decided that P281 Proposed would not prohibit membership of both the Panel and Board, though it is inherent in the solution that it allows Panel and Board members more flexibility with respect to whether they wish to attempt to serve on both (e.g. there would not be a requirement for some industry Panel members to become Board members too; industry Panel and Board membership would be completely independent of one another).

BSCCo Board Transparency and Accountability

The Workgroup considered that P281 Proposed would provide funding Parties with a clear and transparent mechanism to influence membership of the BSCCo Board and remove Board members whose performance they believe is unsatisfactory. It appears Parties do not believe they have any avenue to have input in these areas presently.

The Workgroup discussed a number of measures that they considered might improve the Board's transparency and accountability to Parties. This would increase Parties' confidence that the Board is cognisant of the impacts and risks of its decisions for Parties, and that it gives appropriate weight to these factors in its considerations.

Potential methods of improving Board transparency and accountability might include the inclusion of greater detail in the Chairman's report to the Panel on Board matters; submission of Parties' questions to the Chairman prior to Panel meetings with the Chairman and Board undertaking to respond to reasonable enquiries; and encouraging Parties to question the Chairman at the Annual BSC Meeting.

The ultimate means of delivering Board accountability was through the ability of stakeholders to remove Board members in whom they did not have confidence. As the BSC shareholder, there is provision for National Grid to remove Board members, but the group believed that there was little incentive or opportunity for National Grid to monitor the Board closely, particularly with respect to the needs and concerns of Parties, and it was difficult to envisage circumstances in which National Grid would exercise its power to remove directors.

The Workgroup did not believe that any changes in this area should be progressed under P281, but noted that consideration might be given to whether improvements could be made outside P281. However, if greater transparency and accountability of the Board is achieved via P281, Parties may be better able to identify and substantiate concerns, which could enable them to approach the Panel, National Grid and/or Ofgem and thereby influence National Grid to consider removing Board members if necessary.

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Initial Group views on P281 Proposed

The initial majority view of the Workgroup was that P281 Proposed would not deliver an improvement over the existing Code baseline.

Benefits:

The Proposer reiterated the views set out in the Modification proposal. They emphasised that they believe that drawing Board members from organisations with experience of the energy industry and the BSC arrangements was important given the role of the BSCCo Board in the context of the BSC. As a consequence industry participants would feel more confident in the BSC arrangements and more in control of their own future.

Members supported the suggestion that increased industry input would let Parties feel more in control, promoting confidence.

A member felt that the increased industry input meant the Proposed is better than the baseline, though they had concerns with regard to the independence of elected Board members.

A member observed that there appeared to be tension between the Board's competence and its accountability; and although it has drawbacks, P281 Proposed would improve accountability.

Drawbacks:

A member was concerned by the possible implications of moving from independent Board members who were selected, to Board members required to act independently but elected on a constituency basis. They also noted that Board elections would add complexity to the BSC arrangements.

Though they believed overall the Proposed is better than the baseline, a member felt that there would be no truly independent Board members under the Proposed because the constituency system has an inherent risk that members will represent their constituency.

A member believed a key drawback is the risk to the credibility of Board members elected by constituency. It was also suggested that there was a risk of limiting the pool of available expertise if industry experience is a prerequisite. The Group also noted that there are difficulties around constructing the necessary constituencies.

The Transmission Company Representative stated that at present the Board is impartial, though Board arrangements are not perfect, but P281 Proposed would introduce a risk to Board independence and impartiality. Even in the context of representative elections P281 Proposed was flawed because if there is to be representation of Parties views, the views of *all* Parties and not just generators and Suppliers should be represented.

Initial views on P281 Alternative

The initial majority view of the Workgroup was that P281 Alternative solution would deliver an improvement compared with the existing Code baseline (and that P281 Alternative is also better than P281 Proposed).

Benefits:

The Workgroup believes that P281 Alternative would give industry participants confidence in the constitution of the BSCCo Board and in the process of making appointments to the Board, and that the P281 Alternative would promote established best practices in corporate governance.

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The Workgroup felt the Alternative would deliver Board accountability, a superior Board structure and an improved Board selection process while maintaining the independent ethos of the BSC and allowing all types of Party to have input into the Board appointment process (i.e. not just generators and Suppliers).

Drawbacks:

The Workgroup felt that the Alternative would be beneficial overall, but noted that the changes would add complexity to the BSC (though the Workgroup felt the benefits warrant the additional complexity). Workgroup members did express concern that the Nomination Committee might not be sufficiently transparent, and emphasised that the arrangements and process must be open and incorporate industry input.

Industry Consultation Responses

The Workgroup considered the responses received to the P281 Assessment consultation. The full collated responses are available on the P281 webpage.

P281 Proposed compared with the baseline

The Workgroup noted Scottish Power's response included a comment that for several reasons (it would move away from total independence of Board members, give influence only to generators and Suppliers and facilitate potential undue influence of individual party) P281 Proposed would be detrimental to competition, and therefore detrimental to Objective (c).

The Proposer disagreed with this concern because Board members are required to act impartially and in any case the influence of the Board on operational, day-to-day activities and BSC operations is actually quite limited. Another Workgroup member also disagreed with Scottish Power because they did not believe the concern was linked to Objective (c). However, another Workgroup commented that the Board's decisions on strategy and operations may still have potential detrimental impact on parties not involved in the selection of the Board i.e. any Party not a Supplier or generator, therefore Objective (c) may still be relevant.

Mid-term replacement of Board members

The Workgroup considered E.ON's response to question 5, concerning the approach to replacing a Board member who has not completed their full term. E.ON suggested that an interim Board member appointed to serve until the next election should be selected from the pool of candidates who stood at the previous election in that category, providing they are willing to be appointed. The Workgroup did not raise any issues with this approach, and the Proposer therefore agreed that the Proposed solution should be amended to specify that the Chairman should in the first instance appoint an interim Board member from amongst the pool of candidates in the previous election in the same category as the outgoing Board member, if the Chairman believes it is necessary to appoint an interim Board member and one of the previous candidates is suitable, and providing the Chairman's chosen replacement is willing to be appointed to the Board.

Possible Alternatives

Drax Power's response suggested that several changes might be made to improve the Alternative solution. Drax believed that under the Alternative solution the suggested membership of the Nomination Committee is too narrow, and thought it should provide for direct industry representation. However, the Workgroup believed that because the Chairman of the Board will be an industry appointment, the nomination committee can include a member with 'industry experience' and the Panel can appoint one of its members

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to act as an advisor the Nomination Committee would have adequate industry input and oversight. The Workgroup therefore agreed that no change was required.

Drax suggested that the Nomination Committee Terms of Reference should be subject to BSC Party consultation, not just Panel oversight, to ensure the skills and competencies of the Board adequately reflect BSC Parties' priorities. However, the Workgroup noted that the under the proposed provisions the Board must consult with the Panel prior to finalising or materially changing the Terms of Reference. They also agreed with Scottish Power's response that the Panel would consult with the industry on the initial Terms of Reference, and with also consult on any future changes it considers material enough to do so. It was therefore believed that the Code drafting leaves the Panel with flexibility as to how to do this.

The Drax response also suggested that BSC parties should have the power to dismiss the Board (and thus require its reappointment) by majority vote, to guard against the Board acting without industry support. The Workgroup noted that removing the entire Board would be an extreme measure. Normally underperforming directors would simply not be reappointed at the end of their term. The Workgroup considered that a process to dismiss the Board or a Board member would be complex (necessarily bureaucratic) and lengthy (requiring sufficient notice to organise a vote). The Workgroup concluded that it was ultimately the responsibility of the Chairman, who is accountable to Parties as an industry appointee, to decide whether the Board is functioning and whether Board members are suitable to be considered for reappointment or resign from the post.

In order to make the Board constitution better reflect the source of BSC funding and to make the Board more flexible, British Gas had suggested to increase the number of Board members from the Large Supplier/generator constituencies to 2 each (i.e. 6 industry Board members overall). The Workgroup considered that this proposal would undermine the aim of P281 to increase the relevant expertise on the Board without giving any participants greater influence than others. The Proposer did not wish to incorporate the suggestion into the Proposed solution and the Workgroup did not believe that it was superior to the Alternative solution it had developed and consulted upon.

Interaction with P284

The Workgroup noted that Modification P284, 'Expansion of Elexon's role via the 'contract model', had been raised. The Workgroup considered that P284 has no impact on P281 because it believed that a Board constituted under either the Proposed or Alternative solution could deliver the arrangements proposed by P284.

The Workgroup agreed that transitional arrangements should be added to the P281 Alternative legal drafting to ensure the Alternative solution can be effectively implemented whenever it is delivered. The Proposer confirmed that the Proposed Modification should have similar provisions to ensure the provisions it introduces, if approved, can be implemented in a timely manner no matter what point the cycles of Panel elections and industry Board member appointments were at. The Proposer therefore specified that P281 Proposed contain a requirement that new Directors are put in place by the date three months after the implementation date of P281 Proposed Modification. The Proposed and Alternative legal text drafting has been updated accordingly from that issued for impact assessment.

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8 The Case for Change

This section sets out the final Workgroup's final views on P281 against the Applicable BSC Objectives following its final discussions.

P281 Proposed Modification compared with the existing baseline

A majority of the Workgroup believed that implementation of P281 Proposed would better facilitate the achievement of the Applicable BSC Objectives compared with the existing Code baseline.

These Workgroup members identified the following benefits against Objective (d):

- Appointment of Board members via industry elections would be more transparent and would promote the appointment of Board members with relevant industry knowledge;
- Greater involvement by Parties that fund the BSC arrangements would increase Parties confidence in the performance of the Board and the delivery of the BSC arrangements; and
- The current arrangements limit the range of candidates from which industry Board members can be chosen (i.e. only industry Panel members) - P281 Proposed would increase the number of individuals, and the range of expertise of those individuals, from which industry Board members may be appointed.

The members that supported the Proposed Modification noted the concerns that appointment via constituency election could create a risk to the impartiality of Board members (whether real or perceived), but believed that because Board members are required to act impartially there is no risk.

A minority of the Workgroup believed that the implementation of P281 Proposed would not better facilitate the achievement of the Applicable BSC Objectives compared with the existing Code baseline.

These Workgroup members identified the following detriments against Objective (d):

- Appointment of Board members via constituency elections would raise concerns around the impartiality and independence of such members;
- The proposed election arrangements include only generator and Supplier constituencies and therefore discriminate against other types of BSC Parties;
- The range of Board members' expertise and the ability to select Board members with necessary expertise would be more limited because the Chairman's ability to appoint two independent Board members (besides the industry Panel Board members) would be removed; and
- Appointment via elections would increase the complexity of the BSC arrangements.

One member felt that the identified concerns around impartiality of Board members under P281 Proposed would have a negative impact against Objective (c) because it would allow only generators and Suppliers to have input into Board appointments and there was a risk that a Party could have undue influence due to the election of industry nominees.

Some Group members believed the benefit under P281 Proposed for promoting greater industry input into Board was slightly weakened by the having the Panel appoint the BSC Panel Chair rather than Ofgem.

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P281 Alternative Modification compared with the existing baseline

The Workgroup unanimously believed that implementation of P281 Alternative would better facilitate the achievement of the Applicable BSC Objectives compared with the existing Code baseline.

The Workgroup identified the following benefits against Objective (d):

- Parties have increased input into Board member appointments resulting in greater industry oversight and empowerment;
- Increased range of individuals and expertise from which industry Board members may be appointed; and
- The tension caused by individuals acting as both Panel and Board industry members would be removed.

P281 Alternative compared with P281 Proposed

A majority of the Workgroup believed that implementation of P281 Alternative would better facilitate the achievement of the Applicable BSC Objectives compared with implementation of P281 Proposed.

These Workgroup members identified the following benefits against Objective (d):

- Removes concern around risk to impartiality as a result of a constituency election process;
- Removes the limitation of input to only generators and Suppliers; and
- Increases the breadth of expertise available to serve on the Board.

The Proposer believed that implementation of P281 Proposed would better facilitate the achievement of the Applicable BSC Objectives compared with implementation of P281 Alternative. The Proposer believed that P281 Proposed would deliver greater transparency and Party input than P281 Alternative, and would therefore have greater benefit against Objective (d).

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9 Further P281 Assessment

Background

The original P281 Assessment Report (v1.0) was presented to the BSC Panel on 14 June 2012. The Panel discussed P281 extensively and identified a number of areas where it believed further detail or clarification of the Workgroup's Assessment was required to enable it to fully consider P281 and progress it to the Report Phase. The Panel also considered that some areas of the legal text could be clarified and/or simplified or which the Workgroup should consider to ensure the text delivers its agreed P281 Proposed and Alternative solutions.

This section sets out the Panel's concerns and queries and the Workgroup's responses. Amendments to the solution and legal text resulting from the Workgroup's further assessment are also detailed in this section.

Further Assessment and Workgroup recommendations

The Workgroup undertook further Assessment of P281 at the direction of the Panel - some changes and clarifications were made to the solution and legal text, but the Workgroup did not change its conclusions or its recommendations to the Panel.

P281 Alternative

Legal text v0.4

Paragraph C4.1.4(a) of the P281 Alternative legal text states that in respect of the Nomination Committee Terms of Reference the Board shall 'consult with the Panel prior to finalising, or approving material changes to, the terms of reference'. The Panel suggested that the wording 'finalising' does not make it clear that this means that this provision applies to the initial ToR, and that it is not clear whether the solution intends the Panel's response on ToR changes to be binding and, if so, whether the proposed text delivers this.

The Workgroup considered that as drafted the paragraph refers to both initial Terms of Reference and any subsequent version, though this could be made clearer, and the Panel's views would not be binding on the Board. The Workgroup clarified that the intent of the Alternative solution was that the Panel's views on the ToR would be binding on the Board. The Workgroup acknowledged that as the Nomination Committee will be a Board committee, with authority delegated from the Board, this arrangement would be unusual, but considered that in the case of BSCCo it was appropriate and would give confidence to BSC parties.

The Workgroup therefore agreed the Alternative legal text be updated to clarify the application of the requirement to the initial ToR and reflect that the Panel's views are binding, i.e. the Panel effectively approves (or not) the ToR.

Paragraph C4.1.5(b) states that 'a majority of the Nomination Committee shall be independent non-executive Directors and at least one shall also be independent within the meaning of paragraph 4.1.3(c)'. The Panel considered the references to 'independent' and 'non-executive' to be confusing and possibly unnecessary, and asked the Workgroup to confirm the intent and, if possible and appropriate, to clarify and simplify the provision.

The Workgroup noted that the first part of the paragraph, stating 'a majority of the Nomination Committee shall be independent non-executive Directors' reflects the Corporate Governance Code, and is not intended to restrict participation of industry expert Board members. However, the Workgroup acknowledged that its inclusion could cause confusion and therefore agreed that it should be removed.

Paragraph C4.1.3(a) states that 'the Nomination Committee shall, in recommending appointments to the Board, have appropriate regard to reflecting different classes of, or categories of, industry participants on the Board'. The Panel queried why the provision refers to 'industry participants', not BSC Parties only. The Workgroup noted that the

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provision had wider scope than just Parties to allow the Board to consider industry participants that are not BSC Parties, in a similar way, for example, that the Panel features members from consumer bodies.

The Panel queried how industry views would be taken into account by the Nomination Committee and how it would be accountable (to the Panel and to BSC Parties) and requested clarification of the considerations and views of the Workgroup in this respect.

The Workgroup noted that the Committee will be chaired by the Board/Panel Chairman, who under the existing licence requirement will in the future be a Panel appointee, and in addition the Panel has the right to appoint a Panel member to act as an advisor to the Nomination Committee (under 4.1.6), which provides a link to the Panel and hence industry. This is intended to assure all concerned (Nomination Committee, Panel, Parties and wider industry) that the Committee is conducting appointments in a manner that is mindful of industry views.

Ultimately the Panel can remove a Board member under the new provisions in B6.2 where the Director has not complied with the Nomination Committee's terms of reference (which the Panel is consulted upon).

A Workgroup member noted that if P281 Alternative were to be approved the current Chairman, appointed by Ofgem rather than the Panel, would likely to still be in place, which the member felt would weaken the link to industry views somewhat, though this was assuaged by the Workgroup's considerations with respect to the size of the Board, as set out below.

To ensure accountability to BSC Parties the Workgroup agreed that the Nomination Committee Member should include at least one Board member with relevant industry experience.

Overall, the Workgroup considered that the provisions would ensure industry views are taken into due consideration by the Nomination Committee and would ultimately deliver appointment to the Board of individuals with industry knowledge, as sought by P281.

Transitional arrangements

The Panel sought clarification around how the initial Nomination Committee would be formed upon implementation of P281 Alternative, and who it would comprise, noting that a 'P281 style' Board would not be in place at that time.

The Workgroup noted that under the P281 Alternative solution a valid nomination committee can be formed by a Board appointed under the existing arrangements; nothing in the drafting prevents existing Board members comprising the Nomination Committee. In addition, the drafting provides for transitional arrangements under which ad-hoc Directors could be initially appointed, who would also be eligible for the Nomination Committee.

Length of term

The Panel noted that the Proposed Modification provides for staggered appointments to ensure that the entire Board is not refreshed at one time, but that the Alternative does not include similar explicit provisions for staggering Board appointments and terms. The Panel also felt that a maximum two year length of term appears short. The Panel asked for clarification of the Workgroups considerations and views in these areas.

The Workgroup considered that explicit provision to deliver staggered Board appointments and terms was unnecessary under the Alternative because there is no requirement or

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driver for new appointments to occur simultaneously (whereas under the Proposed solution the election cycle drives appointments). In addition, terms under the Alternative are ***up to*** two years, so Directors could be appointed for a shorter period to achieve staggering.

A maximum term length of two years was used primarily because it is consistent with the current provisions; the Panel term is two years and Directors appointed by the Chairman have a term of up to two years under C4.3.2(a). In addition there is more opportunity for refreshing the Board compared with a longer term, and via the Panel's input into that process greater opportunity for Panel (and therefore industry) input.

Size of the Board

The P281 Alternative solution presented in version 1.0 of the Assessment report, and accompanying legal text, limited the size of the Board to five (four Directors and the Chairman). The Panel noted that this would effectively preserve the status quo, and had some concerns around this approach which meant they would like to better understand the Workgroup's considerations in this area and requested that the Workgroup confirm its agreed approach in this area after further consideration.

Panel members' particular concerns were that limiting the Board to five members would unduly restrict the Nomination Committee in selecting expertise and would not address the defect identified by P281 of non-industry Board members and the Chairman being able to carry decisions against the industry members.

While acknowledging that limiting the Board to five is not usual corporate governance practice, the Workgroup had considered that in the case of BSCCo it was sensible for the Code to limit the number of Board members to preclude the possibility of the Board becoming inappropriately large, and thus less effective, and a Board of five had served adequately for BSCCo so far. The Workgroup had also considered that the change to the Chairman being a Panel appointee would shift the balance of the Board such that the concern of industry Board members being outvoted by the Chairman and other members would be alleviated.

However, having considered the points raised by the Panel, and also taking into account that the Chairman would likely not be a Panel appointee at the time of P281 implementation, the Workgroup revised its conclusions in this area. The Workgroup believed that the Nomination Committee should be free to determine the size of the Board, with the proviso that the majority of Board members (excluding the Chair) must be industry members. A Workgroup member, while agreeing the Nomination Committee should have flexibility in this area, felt that a maximum limit of some kind would still be appropriate, but was satisfied that the limitation of the Board to a reasonable size could be delivered via the Nomination Committee's Terms of Reference.

The Workgroup therefore agreed that the Alternative legal text should be amended to remove the limit on Board size and allow the Nomination Committee to determine the Board's size, subject to the restriction that the majority of the Board (excluding the Chairman) must be industry members.

Nomination Committee Terms of Reference

The Panel discussed whether the initial Nomination Committee Terms of Reference should be produced as part of P281 Assessment, but accepted that under the Alternative solution the Board will produce the Terms of Reference; anything produced by the Workgroup would be indicative only. The Panel requested an overview of the envisaged Terms of Reference to help it consider P281.

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The Terms of Reference will be the widely used Institute of Company Secretaries and Administrators (ICSA) standard, adapted for the BSCCo Nomination Committee to include the requirements set out in the P281 Alternative legal text. The Workgroup has produced an overview of the envisaged Terms of Reference (Appendix 1), with the final version to be produced by the Board for approval by the Panel. The Workgroup agreed that the Terms of Reference should require the Nomination Committee to consider the skills and experience required by the Board and promote the formation of a balance Board.

Determination of Board remuneration

The Code currently provides for Directors nominated by the Chairman under the existing arrangements to be remunerated as determined by the Panel Chairman after consultation with the Panel (C4.4.2). The Panel, including the Chairman, considered that it would be preferable for the Chairman to make a recommendation for ratification by the Nomination Committee/Board, and therefore asked for clarification of any Workgroup considerations in this area.

Neither P281 Proposed nor P281 Alternative seeks to change the process around remuneration of the Board, and the existing provisions are therefore maintained under each. The Board does currently have a remuneration committee to look, amongst other things, at the non-industry Directors' remuneration, so any change to their remuneration would need to be approved by the Board. All that the Code provisions aim to achieve is that the Chairman also consults with the Panel as part of the process.

The Workgroup considered remuneration in light of the points raised by the Panel. Some Workgroup members believed that industry Board members under the P281 arrangements should be paid, with the Nomination Committee Terms of Reference allowing some discretion around pay, to ensure that Board members of the right calibre can be found (i.e. without the framework of Panel elections).

Other Workgroup members considered changes to Board remuneration arrangements to be outside the scope of P281, i.e. P281 seeks only to change the composition of the Board and the means of Board appointments, and remuneration should be considered separately. Workgroup members also argued that it should be possible to find industry participants that wish to join the Board without remuneration as a motivation, as they felt that even without the framework of Panel membership and elections there would be individuals who would wish to be involved with the Board to contribute their expertise.

The Workgroup agreed that no changes around Board remuneration arrangements should be added to the P281 Alternative solution or legal text, but that the Panel and Workgroups considerations should be noted with view that a separate change in this area may be usefully progressed in the future.

Appointment of Panel Chairman

A change was included in P281 Proposed and Alternative to update the BSC to reflect that the Panel/BSC Chairman shall be appointed by the Panel (and ratified by Ofgem), in line with the current provisions of the Transmission Licence. The Panel was uncomfortable with the approach of reflecting the License wording the Code and was not satisfied that this approach had resulted in the Workgroup giving sufficient consideration to this area of the Modification.

Some Panel Members felt this aspect should be removed if possible and progressed as a separate Modification, under which consideration could be given to how the Panel would appoint a Chairman or it might be concluded that the Code change should be made and the appointment process considered outside the BSC Modification process.

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The Workgroup noted that the P281 Modification Proposal included this aspect explicitly, in the form of a suggestion that the Board include an independently appointed Chairman whose appointment will be ratified by Ofgem. Because the Transmission Licence (which would prevail over the Code provisions) had already been changed the Workgroup was satisfied that a change to reflect the Licence provisions would satisfy this aspect of P281, and that this should be done under the Alternative as well as the Proposed.

The proposed Code changes are minimal because the Workgroup did not believe there was any reason to increase the level of detail in the BSC around appointment of a Chairman. The change (under P281 Proposed and Alternative) gives the Panel the power to appoint the Chairman but, other than requiring it to consult with the Board, does not impose an appointment process. P281 therefore does not prevent the Panel from debating the appointment process, or prevent any Party raising a Modification Proposal (or a Standing Modification Group Issue) to allow industry participants to consider prescribing a process in detail in the Code.

The Workgroup was satisfied that the Panel would establish and conduct a robust and effective process to appoint a suitable Chairman.

Other Changes Resulting from Further Assessment

As well as the changes and clarifications set out above in response to points raised by the Panel, the Workgroup agreed that some other changes should be made as a result of its further consideration of P281.

Removal of Eligible Directors by the Panel

Paragraph B6.2.14 of the Alternative legal text specifies the requirements around a vote by the Panel to remove an Eligible Director. The Workgroup considered that a Panel decision to remove an Eligible Director should be clear and therefore a clear majority should be required. However, the Workgroup reconsidered the requirement for all but one of the Panel to vote to remove the Director in order for that Director to be removed, and agreed that this threshold was too high. The Workgroup agreed that a two-thirds majority of Panel members votes would be an appropriate requirement to effect removal of a Director, and the Alternative legal text has been amended to reflect this

Deviations from Nomination Committee Terms of Reference

Though absolutely in support of the requirement that the Nomination Committee Terms of Reference should be required to be approved by the Panel and that the Nomination Committee must adhere to its Terms of Reference (and if it does not the Eligible Director is liable to be removed by Panel vote), the Workgroup considered that there should be some scope for flexibility to deviate from the Terms of Reference if necessary, so long as this is done in a transparent and managed way.

The Workgroup therefore agreed to add in paragraph C4.1.7 of the Alternative legal text a provision that if the Nomination Committee deems it necessary to not comply with its Terms of Reference it must get Board and Panel approval before the non-compliance. This scope for managed non-compliance is accordingly recognised in paragraph B6.2.9(b).

Require at least one industry Director on the Nomination Committee

The Workgroup considered that, as well as the Nomination Committee being required to include at least one Director independent of the industry, the inclusion of at least one industry Director on the Nomination Committee should be mandated. This requirement is therefore specified in paragraph C4.1.5(b) of the Alternative legal text.

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Interaction with further Assessment of P281

As set out in section 9, above, P281 underwent a further period of Assessment after the first version of the Assessment Report was presented to the Panel. The discussions and views set out in this section relate to version 2.0 of the P281 Assessment Report and the legal text attached to it.

The Panel noted the responses, clarifications and further work set out above and was satisfied with the Workgroup's further Assessment of P281.

Discussion leading to initial Panel views for consultation

The Panel noted that the appointment of the Panel Chairman by the Panel for ratification by Ofgem remained part of both the P281 Proposed and Alternative Modification following further Assessment of P281, and considered the Workgroup's rationale for this. The Panel was comfortable with this and satisfied with the Workgroup's conclusions. However, the Panel requested that the relevant provisions in the legal text be amended to clarify that a notice of the nominated and appointed Chairman would be circulated only when the Panel's choice has been ratified by Ofgem.

The Panel considered the overview of the envisaged Nomination Committee Terms of Reference, included as an appendix of the Assessment Report (and also Appendix 1 to this Draft Modification Report). A Panel Member suggested that the Terms of Reference should include specific reasons that the Panel may act to remove a Board member, which the Nomination Committee should take into account. Following implementation of P281 Alternative, if approved, the Terms of Reference would be produced by the Board for approval by the Panel, and this may be considered.

The Panel considered the provisions under the Alternative for the Panel voting to remove an appointed or re-appointed Director (new paragraphs 6.2.9 - 6.2.15 of Section B in the Alternative legal text). A Panel Member believed that it was not clear from the text that if the Panel is to consider removing any Eligible Directors it would do so at a meeting convened immediately after the Annual BSC Meeting. This is because though this is explicitly stated in 6.2.14 the wording of existing paragraph 6.2.7 is unchanged, and states that 'no vote on any matter shall be taken' at the Annual BSC Meeting. The Panel considered that this could be misleading and asked that the legal text be amended to clarify the interaction between 6.2.7 and the new provisions, particularly 6.2.14.

A Panel Member noted the requirement under 6.2.14 for a two-thirds majority of votes at the Panel meeting in order to remove a Director, and suggested that it should be clarified that this means at least two thirds.

The Panel discussed the provisions for the appointment of Board Directors under Section C of the Alternative legal text. The Panel agreed that the legal text in this respect was acceptable, but requested that Service Providers should be added to 'Party or class of Parties' in the criteria set out in 4.1.3(c)(ii). A Panel Member believed the legal text itself was adequate but the explanation in the Assessment Report was not clear enough, and asked for the explanation included in the Modification Report to be clarified.

Panel Members participating in the meeting via teleconference gave their views on P281, but their views against the Applicable BSC Objectives were not counted in determining the Panel's initial recommendations on P281.

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A Panel Member stated that they would support the P281 Proposed Modification because they believed it achieves the intent of the Modification Proposal and, compared with the Alternative, it is simple. They believed the Alternative to be hugely complex and did not believe that the Panel should be involved in the appointment of Board members to the extent it would be under the Alternative.

Another Panel Member commented that the Proposed Modification did appear to be relatively straightforward, but they were concerned that it restricted input to only generators and Suppliers, and overall did not support P281 and agreed with the Workgroup's arguments against it. The Panel Member supported the Alternative, though they agreed that there should be separation between the Panel and the BSCCo Board.

Two other Panel members participating via teleconference agreed with these views, and did not support the Proposed Modification but believed that the Alternative Modification should be approved.

Views of Panel Members that attended the meeting in person are set out in the initial Panel views on its recommendation to the Authority, below.

Initial Panel views on its recommendation to the Authority

The Distributor Representative did not support either the Proposed or Alternative Modification. They believed the existing Board composition and current system of appointing Board members to be adequate and straightforward, and believed that the Proposed Modification would introduce problems (e.g. raising concerns around Board members' independence, etc. as identified by the Workgroup) and that the Alternative, though it would address the problems of the Proposed, would add considerable unnecessary complexity to the BSC.

A Panel Member noted that BSCCo is an unusual organisation (e.g. in that has only one shareholder) and believed that this meant it was sensible to consider non-standard approaches to governance and composition of the BSCCo Board. The member believed both P281 Proposed and Alternative Modifications to be better than the baseline, and believed the Proposed was better than the Alternative because it is more transparent and would deliver direct accountability of the BSCCo Board to Parties.

Initial views on Proposed compared with Baseline

The initial majority view of the Panel was that implementation of P281 Proposed would not better facilitate the achievement of the Applicable BSC Objectives compared with the existing Code baseline.

The majority of the Panel agreed with the views of a minority of the Workgroup, that implementation of P281 Proposed would be detrimental to the facilitation of Objective (d) for the following reasons:

- Appointment of Board members via constituency elections would raise concerns around the impartiality and independence of such members;
- The proposed election arrangements include only generator and Supplier constituencies and therefore discriminate against other types of BSC Parties;
- The range of Board members' expertise and the ability to select Board members with necessary expertise would be more limited because the Chairman's ability to appoint two independent Board members (besides the industry Panel Board members) would be removed; and

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- Appointment via elections would increase the complexity of the BSC arrangements.

One Panel Member's initial view was that implementation of P281 Proposed would better facilitate the achievement of the Applicable BSC Objectives compared with the existing Code baseline. This member agreed with the majority view of the Workgroup that P281 Proposed would have the following benefits against Objective (d):

- Appointment of Board members via industry elections would be more transparent and would promote the appointment of Board members with relevant industry knowledge;
- Greater involvement by Parties that fund the BSC arrangements would increase Parties confidence in the performance of the Board and the delivery of the BSC arrangements; and
- The current arrangements limit the range of candidates from which industry Board members can be chosen (i.e. only industry Panel members) - P281 Proposed would increase the number of individuals, and the range of expertise of those individuals, from which industry Board members may be appointed.

Question 1

Do you agree with the Panel's view that the Proposed Modification should be rejected?

Initial views on Alternative compared with Baseline

The unanimous initial view of the Panel was that implementation of P281 Alternative would better facilitate the achievement of the Applicable BSC Objectives compared with the existing Code baseline.

The Panel unanimously agreed with the unanimous views of the Workgroup, that implementation of P281 Alternative would have the following benefits against Objective (d):

- Parties have increased input into Board member appointments resulting in greater industry oversight and empowerment;
- Increased range of individuals and expertise from which industry Board members may be appointed; and
- The tension caused by individuals acting as both Panel and Board industry members would be removed.

Question 2

Do you agree with the Panel's view that the Alternative Modification should be approved?

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11 Recommendations

Initial Panel recommendations for consultation

Having considered the P281 Assessment Report, the BSC Panel initially recommends:

- That Proposed Modification P281 should not be made;
- That Alternative Modification P281 should be made;
- An Implementation Date for Proposed Modification P281 of ten Working Days following an Authority decision;
- An Implementation Date for Alternative Modification P281 of ten Working Days following an Authority decision; and
- The proposed text for modifying the Code, as set out in the Modification Report.

12 Further Information

More information is available in:

Attachment **A**: Legal Text Proposed

Attachment **B**: Legal Text Alternative

Attachment **C**: Special Resolution of Elexon Limited (P281 Proposed)

Attachment **D**: Special Resolution of Elexon Limited (P281 Alternative)

Attachment **E**: Report Phase Consultation Questions

Consultation responses, impact assessments and other documentation can be found on the P281 page of the ELEXON website.

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Appendix 1: Nomination Committee Terms of Reference – outline of proposed contents

The following outline is based on the ICSA Nomination Committee Terms of Reference (http://www.icsa.org.uk/assets/files/pdfs/guidance/071013.pdf), which are widely used as a model. The model terms of reference will be adapted to reflect the requirements of P281.

The terms of reference will include details of each of the following:

1. Membership (which must reflect the requirements of C4.1.1 and C4.1.5 of the P281 Alternative Solution);
2. Committee secretary;
3. Quorum (would normally be 2 but there must be industry representation at all meetings);
4. Frequency of meetings (normally 2 each year but committee can hold more in its discretion);
5. Notice of meetings;
6. Minutes of meetings (who may take and circulate);
7. Panel advisor - the requirements in respect of the Panel Advisor (C4.1.6 of the Alternative Solution) will also be reflected in the terms of reference.
8. Duties include those specified in C4.1.2 of the P281 Alternative Solution and to:
    a. regularly review the structure and composition (including the skills, knowledge and experience) required of the board and recommend any changes to the board;
    b. ensure that the structure and composition of the board:
        i. has appropriate regard to reflecting different classes of, or categories of industry participants;
        ii. has appropriate regard to reflecting the needs of BSCCo based on its role and function as specified in the BSC (which may include appointing non-executive directors with skill, knowledge and experience in areas including finance and IT);
    c. give full consideration to succession planning for directors;
    d. be responsible for identifying and nominating for the approval of the board, candidates to fill board vacancies as and when they arise;
    e. before any appointment is made by the board, evaluate the balance of skills, knowledge and experience on the board, and, in the light of this evaluation prepare a description of the role and capabilities required for a particular appointment having regard to the considerations set out in (b) above. In identifying suitable candidates the committee shall:
        i. use open advertising or the services of external advisers to facilitate the search;
        ii. consider candidates from a wide range of backgrounds;

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iii. consider candidates on merit and against objective criteria, taking care that appointees have enough time available to devote to the position.

f. review annually the time required from non-executive directors. Performance evaluation should be used to assess whether the non-executive directors are spending enough time to fulfil their duties;

g. ensure that on appointment to the board, non-executive directors receive a formal letter of appointment setting out clearly what is expected of them in terms of time commitment, committee service and involvement outside board meetings.

The committee would also make recommendation to the board on:

a. formulating succession plans for directors;

b. membership of other board committees (in BSCCo currently all directors are members of all committees);

c. the re-appointment of any non-executive director at the conclusion of their specified term of office having given due regard to their performance and ability to continue to contribute to the board in the light of the knowledge, skills and experience required;

d. any matters relating to the continuation in office of any director at any time including the suspension or termination of service of an executive director as an employee of the company subject to the provisions of the law and their service contract.

9. Reporting (the committee would report to the board and would also contribute to the company's annual report).

10. Other (e.g. the committee will review its own performance annually).

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