

## P325 'Improving the accountability of BSCCo to stakeholders and better aligning BSCCo governance with best practice'

This Modification Proposal seeks to amend the ownership structure of BSCCo by issuing shares in BSCCo to BSC Parties, Distribution Network Operators, new entrants, National Grid and the Authority. This will allow BSCCo to operate a governance model entirely consistent with the UK Corporate Governance Code.



ELEXON recommends P325 is progressed to the Assessment Procedure for an assessment by a Workgroup

This Modification is expected to impact:

- BSC Parties
- BSCCo (ELEXON)
- National Grid (BSCCo Shareholder)

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## About This Document

This document is an Initial Written Assessment (IWA), which ELEXON will present to the Panel on 13 August 2015. The Panel will consider the recommendations and agree how to progress P325.

There are four parts to this document:

- This is the main document. It provides details of the Modification Proposal, an assessment of the potential impacts and a recommendation of how the Modification should progress, including the Workgroup's proposed membership and Terms of Reference.
- Attachment A contains the P325 Proposal Form.
- Attachment B contains Appendix 1 to the P325 Proposal Form.
- Attachment C contains Appendix 2 to the P325 Proposal Form.

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# 1 Why Change?

## Background

### What is the BSCCo?

ELEXON Limited fulfils the role of the Balancing and Settlement Code (BSC) Company (BSCCo) as defined in BSC Annex X-1.

[BSC Section C 'BSCCo and its Subsidiaries'](#) sets out the powers, functions, responsibilities and constitution of BSCCo, whose principle role is to give proper, effective and efficient implementation of the BSC.

### What is the function of the BSCCo Board?

Under the BSC, the Board is responsible for:

- Appointing the BSCCo Chief Executive after consultation with the Panel (BSC Section C4.6); and
- Approving BSCCo's Annual Budget following consultation with BSC Parties and other interested parties (BSC Section C6.4).

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. However, requirements (e.g. regarding quorum at meetings) are included in BSCCo's Articles of Association.

### Knight Report 2013

Early in 2013, the BSCCo Board and BSC Panel jointly commissioned an independent review of BSC governance. They appointed former Council of Lloyd's deputy Chairman Bill Knight to undertake the review. Consequently, the [Knight Report](#) was published in July 2013 and looked at ELEXON's current governance. This was with regard to the confines of the BSC, particularly in the light of discussions over recent years in relation to changes to BSCCo's vires.

### What is the issue?

The Proposer agrees with the conclusions of the Knight report and contends that the current BSCCo governance model does not allow the BSCCo Board to function with optimum efficiency. They believe that current provisions restrict BSCCo's ability to comply with good corporate governance, as set out in the [UK Corporate Governance Code](#).

In particular, the Proposer believes that lack of accountability and greater alignment with the UK Corporate Governance Code could be resolved if ELEXON were to have shareholders. Currently, BSCCo is a wholly owned subsidiary of National Grid, and as such has only one shareholder who, because of conditions in their Transmission Licence, cannot act in the same way as a normal shareholder in terms of, for example, electing Directors etc..

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### Proposed solution

P325 seeks to amend the current provisions in BSC Section C to make BSCCo accountable to its shareholders. To achieve this, P325 proposes to issue shares in BSCCo to BSC Parties, Distribution Network Operators (DNOs), new entrants and the Authority, as well as convert the existing National Grid shares into a single share.

Dividends on shares would be possible. It would be for the Board and the shareholders to determine if a dividend should be paid and the amount. This Modification does not require that a dividend be paid, but it would permit one to be paid.

Any changes to the documents governing BSCCo; i.e. the Articles of Association, Memorandum of Association or Shareholders Agreement; would only be approved if a majority of all shareholders vote for the change and the Authority supports the change.

For all other matters that require a shareholder vote, this will be achieved via a resolution at either the Annual General Meeting or an Extraordinary General Meeting of shareholders. The threshold to carry the vote (of the BSC Parties, DNOs and new entrants' shares) shall be a simple majority of 50% plus one share. This shall include the appointment of all Directors of the Company and the Chairman.

The trading of shares directly between parties would not be permitted. All trades could only be completed via the Nominee Account.

The different types of shares, and their impact, are described below:

### The Authority

A single Class A share in BSCCo would be created and allocated to the Authority. The Class A share will not receive any dividend or any payment beyond that one share's face value (of £1) if the company is sold.

The Class A share has veto right on any voting for changes to BSCCo's governing documents. It must also support the appointment of the BSCCO Chairman (following support from other shareholders). If the Class A share eligible to vote does not support the appointment of the Chairman then the appointment shall not be made.

### BSC Parties

#### Allocation

10,000 Class B shares in BSCCo would be created with a nominal face value of £1 per share. These will be allocated annually to BSC Parties based on their funding share. Each BSC Party will therefore be allocated, for a single year duration, one Class B share per 0.01% of BSC funding that they pay each year.

Class B shares may only be 'sold' or 'bought' by BSC Parties and may not be held by any other party but a BSC Party or the Nominee Account.

If a party no longer remains a BSC Party then their Class B shares shall be transferred to the Nominee Account until the next annual reallocation of Class B shares.

## Reallocation

A reallocation of the Class B shares will take place annually based on any changes in the BSC funding share allocations in the preceding year.

By way of simple illustration, if we assume, in the first year, there are ten BSC Parties, all having exactly the same funding share (of BSC costs), then all ten parties are allocated 1,000 Class B shares each (and be invoiced for £1,000 each). However, in year two, Party A's funding share declines, for example, to 9.99% and Party B's funding share increases to 10.01% (the other eight parties remain the same). In this simple example, Party A will be allocated 999 shares (in year two) and will receive a credit of £1 for the one share it is required to sell back. Party B will be allocated 1,001 shares (in year two) and will be debited £1 for the one additional share they receive for the year in question.

Where a BSC Party has less than a full 0.01% annual funding share then they would not receive one Class B share. For example, if Party X has a BSC funding share of 9.999% they would only receive 999 shares (not 1,000 as they are just short of 10%). Equally if Party Y has 10.001% they will only receive 1,000 shares (not 1,001).

## Nominee Account

As a result of the proposed share allocation there will be a rounding 'error' each year of a few Class B shares which are not allocated to BSC Parties. These Class B shares will be held in a Nominee Account (as will any Class B shares returned due to a party no longer being a BSC Party). All shares held in the Nominee Account will be allocated at the next annual reallocation.

In the case of any monies due to be paid out to Class B shares during a year, all funds allocated to be paid to the shares in the Nominee Account will be reallocated.

In the case of any vote of shareholders taking place, those shares held in the Nominee Account would abstain entirely from all shareholder votes.

## National Grid

In addition to the issuing of other classes of shares, and in recognition of their role as GB System Operator, all the current shares held by the Company (National Grid) in ELEXON (BSCCo) will be converted into a single Class C share, in recognition of their existing licence position and shareholding in BSCCo.

The single Class C share (with a face value of £1) would be issued to, and could only be held by, the GB System Operator. It is proposed that this Class C share would have exactly the same rights and limitations as the single Class A share, except with respect to any vote relating to the appointment of the BSCCo Chairman, where the Class C share would have the same rights as the Class B shares.

## DNOs

It is proposed that a special class of shares in BSCCo would be created for DNOs and Independent DNOs (IDNOs). These Class D shares would only be able to be held by those parties who the Authority confirms as being either a DNO or IDNO.

As with Class B shares, these Class D shares would be valued at the same nominal £1 and could only be purchased or sold (from/to the Nominee Account) on the same annual date

as the Class B shares. DNOs and IDNOs would have the option, exercisable once every year, to buy or sell their Class D share(s). Unlike other BSC Parties, who are liable to pay towards BSCCo costs, a DNO or IDNO would not be required to hold Class D share(s).

DNOs and IDNOs would notify the Nominee Account by a set date each year that they wish to exercise their right to Class D shares. In recognition of the linkage between shareholding and funding, these Class D shares would also come with the responsibility for the year in which each Class D share is held to pay a corresponding proportion of the BSCCo costs for that year.

This contribution to the BSCCo funding costs paid by the Class D shareholder(s) would be deducted from the amount of BSCCo costs to be paid by the other BSCCo funding parties.

Class D shares would have all the same rights, such as voting, and responsibilities as Class B shares.

### **New Entrants**

In recognition of the need to accommodate new entrants, it is proposed that Class E shares would be created. These Class E shares would only be able to be held by those parties who the Authority confirms as being a new entrant.

As with Class B shares, these Class E shares would be valued at £1 and could only be purchased (from the Nominee Account) or sold (to the Nominee Account) on the same annual date(s) as the Class B shares. New entrants would have the option, exercisable once every year, to buy or sell their Class E share(s). Unlike other BSC Parties, who are liable to pay towards ELEXON (BSCCo) costs, no new entrant would be required to hold the Class E share(s). New entrants (confirmed as such by the Authority) would notify the Nominee Account by a set date each year that they wish to exercise their right to Class E shares.

In recognition of the linkage between shareholding and funding, these Class E shares would also come with the responsibility for the year in which each share is held to pay a corresponding proportion of the ELEXON costs for that year. These contributions to the ELEXON funding costs paid by the Class E shareholder(s) would be deducted from the amount of funds to be paid by the other (Class B) ELEXON funding parties.

Class E shares would have all the same rights, such as voting, and responsibilities as Class B shares. Once a Class E new entrant party becomes an ELEXON funding party in their own right; that is they are no longer a new entrant by virtue of having a right to hold Class B shares; they would not be able to hold Class E shares. Their Class E share(s) would be sold back, at £1 per share, on the next annual share allocation date, to the Nominee Account and they would be issued with their corresponding Class B share(s) in accordance with the Class B arrangements set out above.

It is recognised that it is possible that a new entrant may, over the course of time, become part of a corporate entity which is liable to pay towards ELEXON (BSCCo) costs; i.e. it is a funding party. If a Class E shareholding party at some future date becomes part of a corporate entity which holds Class B share(s) their Class E share(s) would, from that date, be sold at the nominal value (£1) to the Nominee Account and they would, from that same date, no longer be liable going forward for the equivalent share of funding ELEXON costs for the rest of the year in question. They would not, from that same date, be able to hold Class E shares in the future.

Further detail on the proposed rules for share allocation, transfer and voting can be found in Attachment B.

## Applicable BSC Objectives

The Proposer believes that P325 will better facilitate:

- **Applicable BSC Objective (d)** as the introduction of new governance arrangements will improve the accountability of BSCCo to stakeholders, and better align BSCCo governance with best practice.

The Proposer contends that the current governance model does not allow the Board to function with optimum efficiency and restricts BSCCo's ability to comply with good corporate governance practice, as set out in the UK Corporate Governance Code. Additionally, the Proposer believes that significant time and effort has been expended over the last few years in considering and attempting to remedy the issue, introducing additional inefficiency.

Whilst initially incurring some expense and complexity to transition to a new governance model, the Proposer believes that in the long-term, Applicable BSC Objective (d) will be better facilitated through the introduction of new governance arrangements, as the Board is made more accountable to BSC Parties (through BSC Parties' rights as shareholders) and the BSCCo is able to govern itself more in line with good corporate governance practice.



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### What are the Applicable BSC Objectives?

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(a) The efficient discharge by the Transmission Company of the obligations imposed upon it by the Transmission Licence

(b) The efficient, economic and co-ordinated operation of the National Electricity Transmission System

(c) Promoting effective competition in the generation and supply of electricity and (so far as consistent therewith) promoting such competition in the sale and purchase of electricity

(d) Promoting efficiency in the implementation of the balancing and settlement arrangements

(e) Compliance with the Electricity Regulation and any relevant legally binding decision of the European Commission and/or the Agency [for the Co-operation of Energy Regulators]

(f) Implementing and administrating the arrangements for the operation of contracts for difference and arrangements that facilitate the operation of a capacity market pursuant to EMR legislation

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## 3 Areas to Consider

In this section we highlight areas which we believe the Panel should consider when making its decision on how to progress this Modification Proposal, and which a Workgroup should consider as part of its assessment of P325. We recommend that the areas below form the basis of a Workgroup's Terms of Reference, supplemented with any further areas specified by the Panel.

### Shares

#### Allocation and transfer

Currently, under BSC Section C2.2, National Grid is the registered holder of all of the issued share capital of BSCCo. The Workgroup needs to discuss the most appropriate mechanism for issuing shares in ELEXON (BSCCo). This includes consideration of BSC Parties in proportion to their annual funding share(s), to DNOs, new entrants, the Authority and converting the existing National Grid shares into a single share. It should consider how shares will be created, who will be responsible for issuing the shares and how Parties will be able to release or receive additional shares. In addition, the Workgroup will need to consider how long shares will be valid and whether there should be a process for reallocating shares at a given point during the year.

#### Voting mechanism

Furthermore, the Workgroup will need to consider the most appropriate voting mechanism for shareholders. It should discuss how voting would work in practice i.e. one entity, one vote to guard against domination by large players or voting by market or funding share etc. In addition, the Workgroup will need to take into account independence and integrity of the voting mechanism and timeliness of voting; whether this is on an annual basis or at any time during the year.

The Workgroup may also wish to take into account as part of its discussions the Proposer's suggested rules for share allocation, transfer and voting as detailed in Attachment B, and the [range of potential voting mechanisms](#) discussed by the Board and Panel in 2014 under a new BSCCo governance model.

#### Impacts on current BSCCo model

The Workgroup should consider the impacts and practicalities of introducing shares in BSCCo on the existing BSCCo model. It should take into account the current Board and Panel set-up and the interactions between the two bodies, ELEXON as an organisation, National Grid as the existing shareholder and whether there are any consequential license implications. The Proposer of P325 contends that any alternative options should ensure compliance with the UK Corporate Governance Code.

## Areas to consider

To summarise the above, the following table details the areas we believe a Modification Workgroup should consider as part of its assessment of P325:

Areas to Consider
<p>What is the most appropriate mechanism for allocating and issuing shares?</p> <ul style="list-style-type: none"><li>• How many shares should be created?</li><li>• Who will be responsible for issuing the shares?</li><li>• How long will the shares be valid?</li><li>• How will Parties be able to release or receive additional shares?</li><li>• Should there be a process for reallocating shares during the year?</li></ul>
<p>What voting rights should BSC Parties have in accordance with their annual funding shares?</p> <ul style="list-style-type: none"><li>• What voting mechanism should be put in place?</li><li>• How will the voting mechanism work in practice?</li><li>• Can the voting mechanism be used at any time during the year or on an annual basis only?</li></ul>
<p>What are the impacts and practicalities on the existing BSCCo model?</p> <ul style="list-style-type: none"><li>• Consider the impact on the existing Board and Panel make up</li><li>• Consider the impact on the existing Board and Panel interactions</li><li>• Consider the changes to ELEXON as an organisation;</li><li>• Consider any potential license implications;</li><li>• Consider the impact on National Grid as the existing license holder/shareholder</li></ul>
<p>What changes are needed to BSC documents and processes to support P325 and what are the related costs and lead times?</p>
<p>Are there any Alternative Modifications?</p>
<p>What are the benefits of P325?</p>
<p>Consider the appropriate implementation approach for the proposed changes</p>
<p>Does P325 better facilitate the Applicable BSC Objectives than the current baseline?</p>

## 4 Proposed Progression

### Next steps

We recommend that the Modification is progressed to a six month Assessment Procedure for consideration by a Workgroup.

The Proposer is not requesting that P325 is progressed as a Self-Governance Modification Proposal. We agree that it does not meet the Self-Governance Criteria (as defined in BSC Annex X-1), because it would have a material effect on the BSC's governance procedures.

### Workgroup membership

We recommend that the P325 Workgroup should comprise of any interested BSC Parties and any other interested parties.

### Timetable

We recommend that P325 undergoes a six month Assessment Procedure, meaning the Workgroup will submit the Assessment Report to the Panel at its meeting on 11 February 2016. Please note that this is an indicative timetable as we are currently unaware of the issues that may be identified in the first Workgroup meeting.

As part of the Assessment Procedure, the Workgroup will need to develop and consider the merits of the Proposed Modification (and any Alternative). We will issue the solution for industry consultation (15 Working Days duration) for industry to comment on the Proposed (and any Alternative) solution.

### Amalgamation

Under BSC Section F2.3, *"the Panel may decide at any time to amalgamate a Modification Proposal with one or more other Modification Proposals where the subject-matter of such Modification Proposals is sufficiently proximate to justify amalgamation on the grounds of efficiency and/or where such Modification Proposals are logically dependent on each other."*

Whilst P325 is addressing a similar defect to Modification Proposal [P324 'Review of BSCCo's governance: introducing improved accountability to BSC Parties'](#), we do not recommend that these Modifications should be amalgamated. We instead propose that the more pragmatic approach would be to progress these two Modifications in parallel, but as two separate changes. This will allow for fuller discussion on the detail of Panel and Board interaction under P324 and on shares and stakeholders under P325. A six-month Assessment Procedure should allow time for these Modifications to be considered individually, however if the time timetable were extended for one it seems practical to extend the timetable for both.



#### What is the Self-Governance Criteria?

A Modification that, if implemented:

(a) is unlikely to have a material effect on:

- (i) existing or future electricity consumers; and
- (ii) competition in the generation, distribution, or supply of electricity or any commercial activities connected with the generation, distribution, or supply of electricity; and
- (iii) the operation of the national electricity transmission system; and
- (iv) matters relating to sustainable development, safety or security of supply, or the management of market or network emergencies; and
- (v) the Code's governance procedures or modification procedures; and

(b) is unlikely to discriminate between different classes of Parties.

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Proposed Progression Timetable for P325	
Event	Date
Present Initial Written Assessment to Panel	13 Aug 15
Workgroup Meeting	W/B 7 Sep 15
Workgroup Meeting	W/B 12 Oct 15
Assessment Procedure Consultation (15 WDs)	23 Oct 15 – 13 Nov 15
Workgroup Meeting	W/B 16 Nov 15
Workgroup Meeting	W/B 11 Jan 16
Present Assessment Report to Panel	11 Feb 16
Report Phase Consultation (12 WDs)	12 Feb 16 – 1 Mar 16
Present Draft Modification Report to Panel	10 Mar 16
Issue Final Modification Report to Authority	11 Mar 16

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## 5 Likely Impacts

This is our initial view of the probable impacts of this Modification. The detailed impact of the Modification will be fully assessed as part of the Assessment Procedure.

### Impact on BSC Parties and Party Agents

Party/Party Agent	Potential Impact
BSC Parties	The proposed changes may introduce the ability for BSC Parties to have shares in BSCCo in proportion to their annual funding shares.

### Impact on Transmission Company

The proposed changes will have a direct impact on National Grid as BSCCo shareholder.

### Impact on BSCCo

Area of ELEXON	Potential Impact
BSC Governance	The governance of ELEXON (as BSCCo) would be amended by P325.

### Impact on BSC Systems and processes

No impact.

### Impact on Code

Code Section	Potential Impact
Section B	Changes will be required to implement the solution.
Section C	

## 6 Recommendations



We invite the Panel to:

- **AGREE** that P325 progresses to the Assessment Procedure;
- **AGREE** the proposed Assessment Procedure timetable;
- **AGREE** the proposed membership for the P325 Workgroup; and
- **AGREE** the Workgroup's Terms of Reference.

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### Recommendation

We recommend the Panel submits P325 to a six month Assessment Procedure.

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## Appendix 1: Glossary & References

### Acronyms

Acronyms used in this document are listed in the table below.

Acronym	
Acronym	Definition
BSC	Balancing and Settlement Code
BSCCo	Balancing and Settlement Code Company
DNO	Distribution Network Operator
IDNO	Independent Distribution Network Operator
IWA	Initial Written Assessment
UK	United Kingdom

### External links

A summary of all hyperlinks used in this document are listed in the table below.

All external documents and URL links listed are correct as of the date of this document.

External Links		
Page(s)	Description	URL
3	BSC sections page on the ELEXON website	<a href="https://www.elexon.co.uk/bsc-related-documents/balancing-settlement-code/bsc-sections/">https://www.elexon.co.uk/bsc-related-documents/balancing-settlement-code/bsc-sections/</a>
3	Bill Knight's Report page on the ELEXON website	<a href="https://www.elexon.co.uk/news/bill-knights-elexon-governance-review-published/">https://www.elexon.co.uk/news/bill-knights-elexon-governance-review-published/</a>
3	UK Corporate Governance page on the Financial Reporting Council webpage	<a href="https://www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance/UK-Corporate-Governance-Code.aspx">https://www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance/UK-Corporate-Governance-Code.aspx</a>
6	Link to the Board and Panel's potential BSC Party voting mechanisms paper on the ELEXON website	<a href="https://www.elexon.co.uk/wp-content/uploads/2014/11/Voting-mechanisms_August-2014_v1-0.pdf">https://www.elexon.co.uk/wp-content/uploads/2014/11/Voting-mechanisms_August-2014_v1-0.pdf</a>
10	Link to P324 webpage	<a href="https://www.elexon.co.uk/mod-proposal/p324/">https://www.elexon.co.uk/mod-proposal/p324/</a>

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