



ELEXON

Stage 03: Assessment Report

What stage is
this document
in the process?

01 Initial Written Assessment

02 Definition Procedure

► 03 Assessment Procedure

04 Report Phase

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.



Modification Group recommends:

Approval of the P281 Alternative Modification



High Impact:

BSCCo (ELEXON) and BSC Parties

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Any questions?

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About this document:

This is the P281 Assessment Report, which ELEXON will present to the Panel on 14 June 2012 on behalf of the P281 Workgroup. The Panel will consider the views and recommendations in this report and agree an initial view on whether or not this change should be made.

This report details the solutions, impacts, costs, benefits and the potential implementation activities associated with P281 and sets out the Workgroup discussions which resulted in the P281 Proposed and Alternative solutions.

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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 Board would consist of a Chairman and 4 other Board members. Candidates for the Board would be selected by a Nomination Committee and would need to be ratified by the Panel. 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.

We believe that besides increased participation in the process of Board appointments, implementation of either the Proposed or Alternative would have minimal impact on Parties. Industry and ELEXON implementation impacts and costs will be established by this consultation and ELEXON's impact assessment.

The Case for Change

The Workgroup supported the intent of P281 Proposed but 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 Workgroup believed that the Alternative is in line with best practice processes and would deliver the increased transparency and greater opportunity for Party input that are sought by P281.

Recommendations

The Workgroup recommends that:

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

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2 Why Change?



The Balancing and Settlement Code Company

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

Current constitution of the BSCLCo Board

BSC Section C4 sets out the existing constitution of the BSCLCo 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 BSCLCo for all liabilities incurred in their role as Directors (C4.5), and are entitled to be reimbursed by BSCLCo 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 BSCLCo, which include provisions relating to the appointment and removal of Directors. BSCLCo's Articles of Association are based on the Companies Act 1985 Table A Articles², and are publicly available through Companies House.

The Board delegates the day-to-day conduct of BSCLCo to the Chief Executive (C4.6.4), supported by the BSCLCo Executive team. The Chief Executive of BSCLCo 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 BSCLCo 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 BSCLCo Board

Under the BSC, the Board is responsible for the:

- appointment of the BSCLCo Chief Executive after consultation with the Panel (C4.6); and

¹ The Chairman is remunerated as the BSC Panel Chairman under BSC Section B2.1, rather than as the BSCLCo 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

Where can I find more information on the BSCLCo Board?

[BSC Section C](#) sets out the current BSC rules regarding the Board's constitution.

You can find details of the current BSCLCo Board members and BSCLCo Executive team members [here](#).

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- approval of BSCL's Annual Budget following consultation with BSC Parties and other interested parties (C6.4). Note that the Panel, not the Board, approves BSCL's annual Business Strategy following consultation with BSC Parties and other interested parties (C6.3).

In addition to its specific BSC requirements, the Board has the wider role of directing BSCL. This role includes responsibility for monitoring BSCL's performance, scrutiny of BSCL's finances and ensuring that BSCL 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 BSCL'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 BSCL Board as follows:

"BSC Board"

The Chairman and the Panel will select four persons to become non-executive directors of the BSCL and to form the BSCL 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 BSCL. 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 BSCL business plan and budget and the monitoring of performance. The fact that the Board will be non-executive, and include representatives of those paying BSCL 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 BSCL 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 BSCL 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 BSCL 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 BSCL Board from the management of ELEXON.

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3 Solution

Below the P281 Proposed Modification is broken down to make it easier to understand. The Groups discussion on the Proposed solution and the Alternative can be found in section 5 of this document.

It should be noted that P281 does not seek to amend the function of the Board, only its constitution.

Board Constitution

Under the Proposed Modification the BSCL 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 BSCL 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 BSCL 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 BSCL 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.
- 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		X		X		X		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.

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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, they were concerned that the constituency election process would raise concerns around 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. As such they developed the Alternative solution which is set out below.

Board Constitution

Under the Alternative solution the Board would be limited to a maximum of 5 members, a Chairman and 4 Directors. The Workgroup considered that 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.

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, at least 50% of the Board members should have relevant electricity experience and at least 2 of the Board members should be non-industry i.e. in the last 5 years they have not 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

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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 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, one or more Board members and any additional support it considers 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 transparency³. 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.

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 i.e. 50% Directors having relevant electricity experience.

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 i.e. decline to ratify their 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.

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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>.

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.

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.

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5 Impacts & Costs

Proposed Impacts and Costs

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.

Alternative Impacts and Costs

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

Proposed Modification Implementation

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

Alternative Modification Implementation

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.

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7 Workgroup Discussions



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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 BSCLCo and ELEXON.

The Workgroup noted that the BSCLCo 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 BSCLCo 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 group 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	<ul style="list-style-type: none">• Consistent - energy volumes can be considered for both generation and Supply• Matches basis of funding share methodology• Represents actual activity and market impact	<ul style="list-style-type: none">• 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	<ul style="list-style-type: none">• 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	<ul style="list-style-type: none">• 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	<ul style="list-style-type: none">• Consistent - energy volumes can be considered for both generation and Supply• Matches basis of funding share methodology	<ul style="list-style-type: none">• 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

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		<p>(average over time period to minimise effect of variations)</p> <ul style="list-style-type: none"> Affected by netting/embedded generation
Supplier MSID count	<ul style="list-style-type: none"> Clear Relatively stable Up to date snapshot at point in time of nominations 	<ul style="list-style-type: none"> 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

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the approach for used in the case of a tie in Panel elections. The Proposer agreed that this should be included in the solution.

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](#).

Is P281 Proposed better than the Objectives?

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.

Replacement Mid-term

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.

Any other 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 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 would 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 Recommendations

The P281 Workgroup invites the Panel to:

- AGREE an initial recommendation that Proposed Modification P281 should not be made;
- AGREE an initial recommendation that Alternative Modification P281 should be made;
- AGREE an initial Implementation Date for Proposed Modification P281 of ten Working Days following an Authority decision;
- AGREE an initial Implementation Date for Alternative Modification P281 of ten Working Days following an Authority decision;
- AGREE the draft legal text for Proposed Modification P281;
- AGREE the draft legal text for Alternative Modification P281;
- AGREE that Modification Proposal P281 be submitted to the Report Phase; and
- AGREE that ELEXON should issue the P281 Draft Modification Report for consultation and submit results to the Panel to consider at its meeting on 12 July 2012.

10 Further Information

More information is available in:

Attachment **A**: Legal Text Proposed

Attachment **B**: Legal Text Alternative

All consultation and impact assessment responses can be found on the [P281 page](#) of the ELEXON website.

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