

Open letter to BSC Parties

7 July 2014

Dear BSC Party,

In April 2013, the BSC Panel and Board jointly commissioned Bill Knight to carry out an independent review of ELEXON's governance. The [report](#) was published in July 2013. It identified some problems that arise from the current arrangements and proposed recommendations for change to address these problems.

In October 2013, Ofgem issued an open letter setting out its initial views on the review's findings. Ofgem urged the BSC Panel and ELEXON Board to work with industry to develop options to address the issues raised.

In November 2013, the new ELEXON Board started to consider the Knight Report, its conclusions and recommendations and consequently it wishes to engage with the Panel and wider industry with a view to moving collectively towards a revised governance model that addresses the problems highlighted by the Knight Report.

The Board's views on the shortcomings of the current governance arrangements

The Board is in unanimous agreement that for an organisation such as ELEXON, with a broad range of stakeholders (some of whom are funding parties), having the correct governance in place is crucial. In broad terms, the Board agrees with the Knight Report's conclusion that the current governance arrangements are not fit for purpose. The Board has identified four key problems with the current arrangements that need to be resolved:

- Non-compliance with the UK Corporate Governance Code
- Lack of clarity in the relationship between the BSCCo Board and the Panel
- Inefficient decision making
- Lack of accountability

Non-compliance with the UK Corporate Governance Code

The Board's biggest concern is that the current governance arrangements do not comply, and are a long way from complying, with the UK Corporate Governance Code. Given the pseudo-public sector nature of ELEXON (driven by its funding model and role as a monopoly service provider) and the increasing public focus on good governance, the Board's view is that it has a duty to work with the industry to refresh ELEXON's governance to bring it in line, wherever possible, with best practice as set out in the Corporate Governance Code.

There are several aspects of the current governance model that do not comply with the Corporate Governance Code, including:

- Directors are not subject to re-election and cannot be removed
- The notion of 'industry' and 'non-industry' directors does not clearly reflect the Corporate Governance Code's concept of 'independent' directors
- The Chairman of the board is not appointed by the board and cannot be removed

Lack of clarity in the relationship between the BSCCo Board and the Panel

The Panel and Board are inextricably linked through a shared Chairman and through their joint responsibility in approving the annual BSCCo business plan. However, as the BSC has bedded in it has become apparent that the relationship between the Panel and BSCCo Board is unclear, and leads to tension and some confusion.

This feature of the governance arrangements and its associated unclear responsibilities leads to other problems:

Inefficient decision making

The approval process for the BSCCo business plan is one example of dual decision making between the Panel and the Board. Although the involvement of two bodies provides additional checks and balances, it results in an inefficient, time consuming process with cross referral between the two bodies and doubling up of work for little tangible benefit. The Board would like to investigate options for an alternative process that maintains the involvement of the industry, whilst also being more streamlined, efficient and – most importantly - compliant with the Corporate Governance Code.

Lack of accountability

The Knight Report identified that the lack of clarity in the relationship between the Board and Panel manifests itself in a lack of accountability: it is difficult to know to whom the BSCCo Board is accountable, given the constraints imposed on National Grid as shareholder under the BSC. It is often unclear where final decisions lie, generating a feeling that the Board is not entirely responsible for the strategy and direction of the business.

What should a new governance model for ELEXON look like?

As a starting point for its considerations of what a new governance model for ELEXON could look like, the Board contemplated three questions. The answers to these questions define some fundamental characteristics of ELEXON as a corporate body and, in the Board's view, should provide the starting principles of any new governance model:

What characteristics define ELEXON?

ELEXON is an independent company which should carry out its activities in the service of the long-term interests of the wider electricity industry.

Maintaining ELEXON's independence is crucial: ELEXON is not-for-profit, and not tied in any way to any specific Party, type of Party or sector of the industry.

Integrity and independence are core attributes of ELEXON that should be maintained.

To whom is the Board accountable?

The Board is accountable to the industry, stakeholders and consumers.

What should the Board take into account when making decisions?

Board decisions should take into account and be for the benefit of the needs of the consumer and the industry.

The ELEXON Board should take a strategic view of the industry, balancing the immediate wishes of specific BSC Parties with considerations of the optimal longer-term development of the industry, including such factors as:

- Integrity and security of critical systems government policy and Ofgem objectives for the energy industry
- Public and regulatory policy issues
- Industry and Consumer interests
- Costs and risks

These factors could be hard wired into the company articles.

The Board has assessed the Knight Report's recommendations against these three principles and concluded that, in many ways, the Knight Model could provide a solution that addresses the current flaws whilst also being consistent with the three principles set out above. A significant advantage of the Knight Model, in the Board's view, is that it would make ELEXON's governance entirely consistent with the UK Corporate Governance Code. However, the Board has some concerns, particularly around the proposed voting mechanism and the suggestion that the Panel and Board be collapsed into one body.

On voting, the Board's main concern is that any voting mechanism should take into account the large funding share of the vertically integrated companies, but balance this against a need to avoid giving undue control to any one Party or small group of Parties.

On the collapse of the Panel and Board into one body, the Board's view is that the Panel's expertise and experience, particularly around the detailed mechanics of the BSC and the Trading arrangements, must be maintained. The Board has concerns that collapsing the Board and Panel into one body and discharging the Panel's obligations through a sub-committee of the Board may not be the best solution and that it could result in a sub-optimal governance solution in the long term.

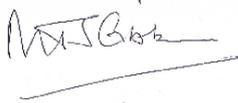
Next steps

The Board has agreed that the current governance arrangements are flawed, and identified some basic principles that any new governance model should take into account. However, the Board also acknowledges that the issue of governance is fundamental to the interactions that ELEXON has with the wider industry and that making changes to ELEXON's governance could have far reaching consequences. Given this, the Board feels that it would be inappropriate to try to impose a solution on the industry.

Therefore, the Board would like to seek the views of BSC Parties to feed into a solution which would form the starting point for a Modification to the Code. The Board has asked ELEXON to engage with BSC Parties in order to ascertain their views.

Over the coming weeks, my colleagues and I will meet with a range of BSC Parties to discuss ELEXON's governance and how it could be improved. If you have views that you'd like to feed into the process, please get in touch.

Yours faithfully,

A handwritten signature in black ink, appearing to read "M Gibbons", with a horizontal line underneath.

Michael Gibbons

ELEXON and BSC Panel Chair