

## EMR – Panel Update

<b>Meeting Name</b>	BSC Panel
<b>Meeting Date</b>	20 March 2014
<b>Purpose of paper</b>	For Information
<b>Summary</b>	This paper is the Panel's monthly update on ELEXON's appointment as the Settlement Agent for both Contracts for Difference (CfDs) and for the Capacity Market (CM).

### 1. Engagement

#### DECC/Counterparty

- 1.1 Engagement with the Counterparty/DECC continues in the following areas:
- Development of the contract between ELEXON and the Counterparty (see para 2.1 below);
  - Governance – we continue to hold weekly catch-up meetings;
  - Agreement of the Counterparty's involvement in our Service Provider BAFO process;
  - Review and comment on the various artefacts that the Counterparty is producing – Business Process Maps (currently being developed by PwC), Traceability Matrices (mapping legislative requirements to systems, processes and organisations);
  - Draft Code and Licence changes;
  - Counterparty's IT systems and interface with the Settlement Agents systems;
  - Attending CM and CfD Business Design Authority forums (change management).

#### Panel/Industry

- 1.2 **Code and Licence changes:** DECC's Code and Licence change consultation closed on 13 February 2014. We understand that DECC received 14 consultation responses. DECC has declined to share the consultation responses stating that it must formulate its own views on the responses and determine whether further changes are necessary. However, DECC has stated that they propose to attend code panel meetings to share their proposed approach to the consultation responses. DECC has not yet confirmed when it proposes to attend the BSC Panel.
- 1.3 **EMR System interfaces:** as mentioned at the last Panel we drafted and shared with DECC/Counterparty, a document setting out the interface options between the CFD/CM Settlement System and Suppliers and Generators. On 11 February 2014 we launched a consultation on the interface options. The consultation closed on 7 March 2014 and we received 24 responses which we are evaluating prior to sharing with DECC.
- 1.4 **Panel Committees:** At a recent Panel Committee meeting a number of questions were raised relating to the interaction between the BSC and the implementation of the EMR arrangements. One of the questions related to the establishment of the subsidiary company and the Panel Committee requested that the ELEXON Board write to the Committee explaining its decision on board membership. This matter was discussed at the ELEXON Board meeting on 5 March and the Chairman has prepared an open letter response to the Panel which is contained in Appendix 1.
- 1.5 Furthermore, the Panel Committee also asked that, in order to improve transparency, a log of all EMR questions raised by Panel Committees be created and published on the ELEXON website. The questions log

and ELEXON's responses to them are available from the ELEXON website at: <http://www.elexon.co.uk/wp-content/uploads/2014/03/BSC-Committees-EMR-Questions-and-Answers-Log-v1.1.pdf>. A note was also included in Newscast on 10 March drawing attention to the questions log.

## 2. Governance

- 2.1 **Establishing a contract with the Counterparty:** We continue to work with DECC and the Counterparty to develop the contractual and structural arrangements for the provision of EMR services. As previously mentioned DECC is proposing a single contract between the ELEXON EMR subsidiary, the CFD Counterparty and the CM Settlement Body, covering both CFD and CM services and this structure and more generally the terms, are being discussed with DECC.
- 2.2 **Establishing the EMR subsidiary:** Following the Board's agreement a subsidiary company called "EMR Settlement Limited" is to be incorporated. The articles of association incorporating standard adaptations from the statutory baseline (e.g. to give the board the power to allow directors to vote on matters on which they are conflicted) and to include a list of "reserved matters" requiring BSCCo board approval, will be in public domain.
- 2.3 **2014/15 Grant:** EMR activities in 2014/15 (as with 2013/14) will be Grant funded by DECC and it is intended that the terms of the Grant will be identical. The amount of the Grant is yet to be determined and is dependent on the outcome of the ITT BAFO responses which are expected in early March 2014. We will be meeting with DECC in early March to finalise the Grant and enable execution.
- 2.4 **Managed Services Agreement and Data Licence:** Good progress has been made in the development of the Managed Services Agreement (MSA) and the data licence. The MSA sets out the arrangements for allocating shared overheads between BSCCo and its EMR subsidiary. The data licence is established to ensure that BSC data is only to be used, by the Settlement Agent for the specified purposes. Whilst this may not be an issue whilst ELEXON is the EMR Settlement Agent, it may become an issue if the role was given to a third party.

## 3. System Procurement

- 3.1 An update on the procurement progress is contained in Attachment 1 (222/10a) which is confidential.

## 4. Requirements' certainty

- 4.1 As mentioned at the February Panel DECC's secondary legislation consultation concluded on 24 December 2013. Despite calls from stakeholder's DECC has declined to make public its proposed policy preferences which it has stated will not be shared with stakeholders ahead of DECC's formal response which is expected in early June 2014.

## 5. Changes to BSC Systems and processes

- 5.1 The majority of the BSC System changes are being implemented in the June 2014 release and will deliver the Supplier and Generator volumes needed by the EMR Settlement Agent to calculate the CFD and CM payments.
- 5.2 Consequential changes to BSC Procedures and other configurable items are required. These changes will be issued for industry review at the end of March through the established communication channels. Overall, the implementation of the June release is progressing according to plan.

- 5.3 A number of other BSC System changes are being considered. In particular, changes to the CRA system to enable BMUs that are associated with a CfD to be identified. DECC has also asked ELEXON to facilitate a workshop to discuss how to implement one of DECC's EMR Demand Side Response metering options based around a HHDA solution. Further system and CSD changes may therefore be required. We will continue to keep the Panel and relevant Panel Committee informed as solutions develop.

## 6. Financial Regulations

- 6.1 There is no further update on when DECC propose to take this matter to the FCA. We continue to maintain the pressure on DECC to bring this issue to conclusion.

## 7. Resource effort and expenditure

- 7.1 CfD/CM expenditure is contained in Attachment 1 which is confidential.

## 8. Recommendation

- 8.1 The BSC Panel is invited to:

a) **Note the EMR update.**

### Appendices:

Appendix 1: Letter from the ELEXON Board Chairman to Panel Members on EMR Corporate Structure and Oversight

### Attachments:

Attachment A: CfD/CM Confidential Update

Attachment B: Wragge & Co Legal Advice

Attachment C: Response to ISG Questions

### For more information, please contact:

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*Panel Members*

*Circulated as **Appendix 1** to Panel Paper 222/10*

13 March 2014

Dear Panel Member

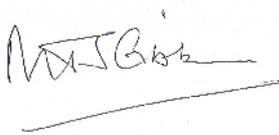
## **EMR – Response to Panel on Questions raised relating to EMR Corporate Structure and Oversight**

A number of questions were raised at the February Panel (and at the ISG in January and February) around the corporate structure and governance of ELEXON's EMR settlement activities, as proposed in DECC's October EMR consultation, ELEXON's November workshop and DECC's January Code and Licence changes consultation.

I want to reassure you that these issues have been carefully considered previously by the Board and the concerns expressed were discussed by the Board again at its meeting on 5 March. The Board understands that a number of questions have been addressed by providing written responses to the ISG which have been published on the ELEXON EMR web page, referenced in ISG minutes and highlighted as part of the weekly "Newscast" to BSC Parties and other industry contacts.

Nevertheless with this letter I want to ensure that all Panel Members are aware of the responses to the ISG on these matters as well as responses to the points made at the last Panel meeting. I would encourage Panel Sponsors to share this letter with their committee members.

Yours faithfully,



**Michael Gibbons**  
**Chairman of BSC Panel and ELEXON Limited**

## 1. Questions raised at the Panel 13 February 2014

The questions raised at the Panel on 13 February can be characterised<sup>1</sup> as:

- *Why are ELEXON's EMR activities to be undertaken via a subsidiary?*
- *Whether to incorporate a subsidiary now is premature given the consultation has [at that point] not closed?*
- *How can BSC Parties be assured that the "Permitted Activities" to be undertaken by the subsidiary are limited to EMR?*
- *Use of BSC assets.*

Taking each issue in turn:

### 1.1 Why are ELEXON's EMR activities to be undertaken via a subsidiary?

*The questioner at the Panel expressed concern that it was being presumed that a subsidiary was the best corporate structure, and instead proposed that ELEXON's EMR activities be undertaken by and within BSCCo. The questioner explained their view was based on the following:*

- *Creating a subsidiary for EMR activities was very similar to the "Subsidiary Model" which had been reviewed during the previous governance and vires discussions and which had been rejected by the Issue 40 Workgroup;*
- *That National Grid was not undertaking its EMR activities via a subsidiary;*
- *That Warm Homes was a (non-BSC) activity undertaken by BSCCo and not by a subsidiary;*
- *That ring fencing to protect BSC Parties could be achieved without a subsidiary and instead if there was exposure relating to EMR activities (whether costs or liabilities) these could be allocated by BSCCo amongst those BSC Parties who should bear them as EMR participants.*

ELEXON has consistently maintained in discussions with DECC that BSC Parties should not bear the costs or risks associated with EMR activities that DECC is asking ELEXON to undertake. Assurances to this effect were provided by DECC to the Panel in May last year and more recently in a statement to the House of Commons, when the Energy Minister wrote: "As this group [BSC Parties] is not identical to EMR participants, passing on costs to BSC parties would not be appropriate". The best way to avoid risks, costs and liabilities landing on BSC Parties is to keep them outside of BSCCo, rather than allow them into BSCCo and then seek to apportion them in some way to be determined. BSCCo will not be providing a parent company guarantee to anyone in respect of the subsidiary's activities (the proposed changes to the BSC prohibit this). A legal explanation is attached prepared by Wragge & Co explaining the rationale for separate companies.

Whilst there are differences between the proposed subsidiary structure and the Subsidiary Model, they are the same in the key regard that non-BSC activities are to be undertaken in a separate company. The Issue 40 Group did not reject this model but it did observe there were issues to be resolved, as it did with the Contract Model. The Issue 40 Group was however clear that in considering the third or "incremental model" where more activities are undertaken within BSCCo, there "are concerns that, as

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<sup>1</sup> Questions were not written but arose during discussion. Confirmation has been obtained from the Panel questioner that these topics accurately reflect their concerns

the BSC grows, BSC Parties may become exposed to a wider set of risks and liabilities" (Issue 40 Final Report section 5.20).

It is correct that National Grid is not setting up a subsidiary. We are unsure of the rationale for this but it may be related to the funding arrangements by which the cost of Grid's EMR activities as agreed with Ofgem, are recovered through the transmission licence.

Warm Homes is a service carried out by BSCCo. The changes to the BSC at the time Warm Homes was introduced provide for both BSCCo to undertake Warm Homes reconciliation and also for a subsidiary to do so. The board concluded that the risks relating to the service, comprising principally the payment of annual charges to CGI did not justify setting up a separate company in order to ring fence those risks from BSC Parties.

## **1.2 Whether to incorporate a subsidiary now is premature given the consultation has [at that point] not closed?**

*The Panel questioner asked whether to incorporate the subsidiary now when DECC's consultation on Code and Licence changes had not [at that point] closed, was premature?<sup>2</sup>*

The Board has authorised the incorporation of the subsidiary given the timing of the Board meetings. If DECC's desired corporate structure changed following its consideration of the consultation responses such that no subsidiary was required then no subsidiary would be incorporated.

## **1.3 How can BSC Parties be assured that the "Permitted Activities" to be undertaken by the subsidiary are limited to EMR?**

*The Panel questioner expressed concern that the use of the phrase "Permitted Activities" in the proposed BSC text changes implied that non EMR activities might be undertaken.*

The proposed changes to the BSC which were included in DECC's January consultation expressly state that only the "Permitted Activities" may be undertaken by the subsidiary and those Permitted Activities are then defined and cover only EMR activities. To go beyond those would require a further modification.

## **1.4 Use of BSC Assets**

*The Panel questioner queried the proposed new clause section C paragraph 10.2.1(a)(ii) of the BSC which restricts "the transfer, lease, licence or loan of any sum or sums, asset, right, or benefit" unless it is "on an arm's length basis and on normal commercial terms". The questioner was concerned that this implied BSCCo could transfer BSC assets to the subsidiary.*

The clause is in fact designed to reinforce the proposed new paragraph at Section C 3.4.6 ("...BSCCo shall not give any cross-subsidy to, or receive any cross-subsidy from, a Permitted Affiliate" by making it clear that use of assets etc. is on an arms-length basis and on normal commercial terms. The

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<sup>2</sup> The question was raised on 13 February, the last day of the consultation.

reference to 'assets' (in addition to sums, rights and benefits) is intended to ensure that this restriction is cast as wide as possible to cover all forms of property or right. In respect of BSC assets, it should be noted that there is a list of restrictions on BSCCo that apply to BSCCo assets and these restrictions are unaffected. As for BSC data, the changes limit the use of such data by the EMR settlement agent to EMR activities and only in accordance with a data licence which is to be shared with the Panel (it is currently being drafted).

Nevertheless we will look at this clause with DECC to see if it duplicates other provisions leading to potential confusion. However, as we are unsighted as to whether this comment was made in any response to the consultation<sup>3</sup>, we cannot be certain if DECC will revisit the clause.

## 2. Questions raised at the ISG Meetings

Written responses to the ISG's January questions were provided to ISG and posted on our EMR web page. Extracts relevant to these corporate issues are attached as an Appendix. A further question was raised at the February meeting:

*The ISG questioner referred to the monthly Panel update (221/14) which stated that the subsidiary board would comprise the BSCCo Chairman, a BSCCo NED and two members of the executive team (with the BSCCo company secretary as company secretary) and they raised concerns around the lack of industry representation on the Board of the EMR subsidiary.*

Subsidiary board membership has been determined by the BSCCo board in its capacity as 100% shareholder. As both boards will have the same chairman and a common non-executive director it is the view of the board that this, coupled with reserved matters (see below) provide sufficient oversight, especially as the Chairman was appointed by the Panel.

In addition it is normally considered good corporate governance in the UK for a Board not to contain representatives of specific interest groups. In this case a representative of BSC Parties' interests would not be strictly appropriate because the subsidiary company interested parties are the EMR parties, a different though overlapping group. Moreover, the government has reinforced the separation of EMR and BSC communities as referred to in paragraph 1.1 above.

To reinforce oversight by the BSCCo board, there will also be some high level matters for the subsidiary board that will require the approval of the BSCCo Board. These are known as "reserved matters" and will include:

- Changes to the subsidiary board's membership
- Any matter that might cause BSCCo to be in breach of its BSC obligations
- Changes to share capital or granting any options
- Extending or terminating material contracts

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<sup>3</sup> It should be noted that individual responses to the code and licence consultation have not been shared by DECC (or by the respondents) with ELEXON and DECC is still considering them.

These matters requiring approval of the BSCCo board will be set out in the constitution (Articles) of the EMR subsidiary and will be shared with the Panel.

Lastly, to assist in understanding the concern, it may be helpful to draw a comparison between BSC and EMR activities:

- For BSC, ELEXON administers the BSC, changes to which are managed via the Panel and approved by Ofgem, and ELEXON subcontracts services to BSC Agents such as CGI;
- For EMR, the Counterparty body administers the EMR regulations, changes to which are overseen by a combination of DECC and Ofgem, and the Counterparty body subcontracts services to the ELEXON subsidiary.

The two are not directly comparable, with the role of the EMR subsidiary being more aligned to the role of a service provider.