

Energy UK response to the DECC/Ofgem consultation on Synergies and Conflicts of Interest arising from the Great Britain System Operator delivering Electricity Market Reform

Energy UK is the trade association for the energy industry. Energy UK has over 70 companies as members that together cover the broad range of energy providers and suppliers and include companies of all sizes working in all forms of gas and electricity supply and energy networks. Energy UK members generate more than 90% of UK electricity, provide light and heat to some 26 million homes and last year invested £10 billion in the British economy.

Members have been following this issue with interest, some participating in the DECC Electricity Market Reform (EMR) Institutional Framework Expert Group, others via attendance at DECC/Ofgem Stakeholder workshops such as the one held 22nd January 2013. We are happy to provide views on this DECC/Ofgem consultation.

When we submitted our previous response on this issue, 4th April 2012, we acknowledged that it may be acceptable to appoint National Grid as System Operator (SO) to an Electricity Market Reform (EMR) central delivery role but only once we knew more about the governance arrangements around the various roles and responsibilities of all key players. DECC has now provided clarification on how the market reform framework will deliver its EMR vision in that:

Government

- ▶ Will set overall policy direction and key parameters
- ▶ Will introduce regulation the terms of the SO Delivery Role and reporting requirements
- ▶ Appoint and define the terms for the Panel of Technical Experts

The System Operator

- ▶ Will be accountable to Government for the EMR Delivery Functions
- ▶ Will provide analysis to allow Ministers to set key policy parameters
- ▶ Administer the allocation of Contracts for Difference (CfDs), which are contracts to support development of low carbon generation signed by a new counterparty body
- ▶ Administer and run the capacity auctions for the Capacity Market (CM), allocating CM Agreements, which are market wide capacity agreements

Ofgem

- ▶ Will regulate the SO Delivery function through a system building on the existing incentive regime
- ▶ Will hold the SO to account for its performance and internal administration costs for EMR

CfD Counterparty

- ▶ Will be owned by and accountable to Government, though operating at arms-length
- ▶ Will sign CfD contracts with projects deemed eligible by Government or the SO
- ▶ Will manage those contracts in line with terms set out in the contracts

Whilst members understand the intent of the proposed structure it is important that DECC and Ofgem identify and explain the interfaces between the SO/Transmission Operator (TOs), the SO/EMR functions and the TOs/EMR. Until such time as this is clear then the full benefits and associated risks remain unknown and subject to conjecture. At the time of this assessment it may be also beneficial to undertake an assessment regarding whether there is any potential for conflict within the EMR design between the CfD and CM functions.

The main concerns remain the treatment of confidential data that the generators are being asked to provide to National Grid and its ability to exercise discretion. It is important for generators to have confidence in the market arrangements and to know that anything they provide will not be used for other, as yet undefined, purposes. The SO already has access to significant amounts of market information and is incentivised to efficiently minimise balancing costs and ensure security of supply.

The additional data provided as part of the cost assessments under EMR for the Strike Price analysis and potentially for the Capacity Mechanism, has been provided for specific reasons. The data is highly confidential to the companies providing it and they need evidence that it will be treated in a secure manner. A demonstration of strong and effective ring-fencing of the EMR functions within the SO activities is a minimum requirement for generator members, many of whom have existing commercial agreements across the National Grid raft of businesses. We await much more design detail before we are able to ascertain the level of conflict regarding discretion but would note that we believe that the industry can work together to deliver acceptable solutions to resolve these issues. We recognise that the key area of concern relates to National Grid's competitive businesses.

At the 22nd January workshop Ofgem provided an overview of the mitigation measures around business separation which included:

Degree of Separation	What is separated from other NG Business?			
	Option A: EMR + SO + TO	Option B: EMR + SO	Option C: EMR	Option D: EMR + SO Targeted
1 Regulation of Information Flows				
2a = 1. + deeper separations (employee, physical, financial)				
2b = 2a + legal separation				

Member preference is for Option 2b + C, although one company believes that full separation as a starting point may be going a step too far and has indicated a preference for Option 2a + A. The reason for the cautious approach is a simple one in that there are many pieces of the whole EMR design yet to be agreed and most members would prefer at this point in time to err on the side of caution and maintain their original stance in this regard. We are encouraged that DECC and Ofgem are continuing to develop further detail and look forward to hearing more.

In summary, we believe that in the absence of further important detail on the proposed EMR framework and governance arrangements, it is difficult at this stage to determine the precise areas of delivery body discretion and information flows that present the greatest risk of conflicts of interest. This highlights the criticality of developing the technical rules and requirements in conjunction with industry rather than in isolation.

Whichever option is adopted we envisage that the EMR Analytical Service and EMR Delivery Role would be delivered based upon the model currently used by National Grid to ensure that it's SO and TO activities are appropriately split. The model would include:

- ▶ Staff located within the same building in offices separated by electronic keypad access provisions who are working under clearly defined confidentiality agreements;
- ▶ Governance provisions delivered via clearly defined rule books/codes, perhaps including one for the Contract for Difference and one for the Capacity Market;
- ▶ Funding of the Business would be clearly prescribed;
- ▶ Staff having the ability to move between different business units within National Grid provided that they have been subject to a suitable cooling off period;

In addition to the table above Ofgem included the following to demonstrate examples of Potential Conflicts:

Ability	Conflicts – Examples
Access to Information (On Government Policy Intentions and Generator Plans)	<ul style="list-style-type: none"> ▶ National Grid Competitive Businesses (Offshore, CCS, Interconnection) are aware of Government Intentions and so have more time to position businesses for opportunities ▶ Commercially sensitive information on competitors
Exercising Discretion and Exerting Influence (over DECC decisions)	<ul style="list-style-type: none"> ▶ Over-estimate capacity required to increase network build (+RAV) in England and Wales ▶ Favour Generation over Demand Side Reduction (DSR) to enhance profits of network ▶ Undue weight to Carbon Capture and Storage (CCS) ▶ Favour flexible generation to make balancing easier
Conflicts are mainly with the electricity TO and the competitive businesses	

We would note that there are three TOs that the GB SO has to interface with.

Ofgem also provided information about perceived synergies and believe that the main conflicts of interest or synergies arising from the National Grid being the EMR delivery body have been broadly identified. It would be helpful, once Ofgem identify the interfaces between the SO/TOs; the SO/EMR Function and the TOs/EMR, that industry is given the opportunity to understand the linkages and data flows. Until such time as this is clear then the full benefits or associated risks remain clouded. In addition Ofgem should assess whether there is any potential for conflict within the EMR function between the CfD and CM functions.

Additional Issues yet to be addressed

We are aware that there are a number of responses from individual members on this topic being prepared so will leave it to members to articulate their individual views on this topic however during our internal discussions members highlighted several issues that require further development and attention which are listed below for your information. We thought that it would be of value to capture this, though all issues below do not directly impact upon this consultation.

Governance – how this is to be designed has yet to be discussed. Members expressed an initial preference at this time for separate CfD and CM codes to be devised and agreed. We are aware that this is to be addressed by the Institutional Frameworks Expert Group in the near future and Energy UK is about to begin the process to identify a range of options for discussion as requested by DECC.

Budget – the linkage to the limits set and discretion provided to the Delivery Body in relation to its operations within the Levy Control Framework remain unknown and were a subject for discussion at

the 22nd January workshop. An indication of where this work is being developed and opportunities for input would be appreciated.

Cost Recovery – we do not yet know the preferred method or approach to cost recovery by National Grid as the Delivery Body for EMR. Is this to be based upon a Funding Shares approach, much like those for the BSCCo or via BSUoS payments? An indication of where this work is being developed and opportunities for input would be appreciated.

Programme of Trialling and Testing and Information Flows – There is not an Implementation Expert Group within the DECC EMR Programme for discussion of any new systems required to support both the CfD and CM. Members are conscious, given the cost and length of design timescales, that we should be starting to look at this more closely.

Should you require any further assistance then please feel free to contact me on 07736 107 020

Regards,

Barbara Vest
Director of Generation
Energy UK