



Department of Energy and Climate Change  
3 Whitehall Place  
London  
SW1A 2AW

Office of Gas and Electricity Markets  
9 Millbank  
London  
SW1P 3GE

29 January, 2013

**E.ON UK plc**  
Westwood Way  
Westwood Business Park  
Coventry  
CV4 8LG  
eon-uk.com

Paul Jones  
024 76 183 383

paul.jones@eon-uk.com

Dear Sir or Madam,

**Synergies and Conflicts of Interest arising from the Great Britain System Operator delivering Electricity Market Reform**

Thank you for the opportunity to respond to the above consultation. In general, we are concerned that there appears to be an assumption that the SO will be able to achieve significant synergies by carrying out its EMR delivery agent and other roles together. We do not believe that the scope for large synergies exists over and above organisation benefits such as shared services and the ability to access employees with the required skills for the role.

National Grid is already a monopoly purchaser of a number of services, with a commercial interest in how they are purchased and often with an information advantage over those who are seeking to provide them. Potential providers of those services will be concerned that additional information and influence afforded to the SO under EMR could be used in such a way so as to effectively distort the market in those services. In saying this, we are not implying that this would be the intention of the SO. However, even the perception that this could happen will undermine investor confidence in the EMR functions and could for instance impact on the willingness of participants to provide the necessary information required for the deliver plan process.

We therefore believe that default position should be that the EMR role should be ring fenced from National Grid's other businesses. Our responses to the specific issues raised are as follows:

E.ON UK plc  
Registered in  
England and Wales  
No 2366970  
Registered Office:  
Westwood Way  
Westwood Business Park  
Coventry CV4 8LG

**1 a) Do you agree that there are unlikely to be material conflicts arising from the electricity System Operator having access to EMR related information? If not, please explain your reasoning.**

No. The assessment of the materiality of the SO profit is a little simplistic in that it simply looks at the profit for 2011/12. This is shown as £9m, but it is not clear whether this includes the money that the SO expects to lose under the Balancing Services Incentive Scheme, which in previous documents from Ofgem was predicted to be over £30m. Also, the level of profit that National Grid currently makes in a particular business area is not necessarily directly proportionate to the potential to make further profit in that area. Under the current BSIS scheme there is the potential to make a £50m profit or a £50m loss, a range of £100m. There would therefore seem to be a large incentive for the SO to use information that it receives under an incentive scheme to its benefit. Of course, Ofgem is proposing on removing this incentive for 2013/14, but there is still likely to be the potential for National Grid to gain or lose significantly from a financial perspective under Ofgem's proposal for a replacement scheme. Furthermore, the arrangements need to be robust to ensure that they remain appropriate should such a scheme be reintroduced in future years.

Whether or not the opportunity to benefit arises directly from receiving EMR related information is another issue. It is true that it is probably the SO's ability to influence analysis and policy, and its discretion to make decisions under EMR that would allow it to actually gain from any conflict of interest. However, access to the relevant data would allow the non EMR related parts of the business to assess whether or not actions from the EMR delivery agent functions would be beneficial to them which could inform subsequent behaviour.

**1 b) Do you agree that there is significant potential for synergies as a result of the electricity System Operator having access to EMR related information? If not, please explain your reasoning.**

We believe that it is dangerous to assume that all data should be passed between the SO's EMR Delivery Agent and its unrelated functions, and leave the burden of proof on those who believe that it is unnecessary and/or inappropriate. This is a very complex area and it would be unrealistic to expect those parties to be able to think up all instances when information could be used inappropriately and propose specific mitigations against them.

It is not obviously apparent that particular synergies from information are available. If the System Operator needs additional information in order to achieve significant improvements in its performance, then we would expect it to come forward with proposals to do so through the relevant industry codes. It would then be up to the SO to argue the merits of such proposals on a case by case basis and would allow for proper assessment and scrutiny from the industry and Ofgem.

We support data transparency in promotion of competitive markets. However, in this instance the information would not be provided to assist the functioning of a competitive market, but would give additional information and bargaining power to a monopoly purchaser of services, which stands to gain commercially from how those services are purchased. Our concern is that it is this behaviour would undermine competition in the market for those services.

We also believe there is a significant danger that information that is provided to the EMR Delivery Plan process could be used erroneously and out of context for the wider SO function. For example, cost data that is provided on a long term forecast basis, in order to inform decisions to provide long term incentives and support under EMR, is not likely to be suitable for procuring services such as frequency response under shorter term timescales.

**1 c) Do you agree that the potential for conflicts and synergies arising from the electricity Transmission Owner having access to EMR related information is limited? If not, please explain your reasoning.**

We would be extremely concerned if the data that we provide on our generation interests under EMR were to be made available to any TOs, particularly those TOs who have associated generation and supply interests of their own. We therefore fundamentally believe that such data should not be provided to TOs.

**1 d) Do you agree there are limited conflicts with gas distribution, gas transmission and gas system operation arising from access to EMR information? If not, please explain your reasoning.**

As with our answer to the response to question 1b), if any of these businesses were lacking information that could improve their performance in serving their customers, then we would have expected them to have raised the relevant proposals already to acquire that data. The default position should be that this data is not provided to them unless a strong business case is made which can be properly assessed by the industry and Ofgem under the appropriate governance process.

**1 e) Are there any other conflicts of interest or synergies associated with access to EMR related information for businesses operating in mainly monopoly conditions that we have not identified?**

Given the complexity of the arrangements we do not believe that it is possible to think of every instance where a conflict may arise.

**2 a) Do you agree that the most material potential conflicts of interest with competitive businesses as a result of National Grid's increased access to information have been identified? If not, please identify which ones are missing, explaining your reasoning and providing evidence.**

They seem to be yes.

**2 b) Do you agree that where competitive businesses are concerned, there is a need for additional mitigation?**

We agree that there is a need for mitigation. We believe that this should form part of the general business separation processes that are put in place to keep the EMR Delivery Function separate from all other National Grid businesses, with competitive and monopoly businesses being treated alike.

**2 c) Are there any other conflicts of interest or synergies with businesses operating in mainly competitive conditions that we have not identified?**

We do not have any more examples to provide. However, in such a complex area there is always the scope for conflicts to arise that had not initially been thought of.

**3 a) Do you think that all the major potential conflicts of interest and synergies arising from an ability to exert influence have been identified? If not, please identify which ones are missing, explaining your reasoning and providing evidence where possible.**

The issues identified are valid. As with our answers to other questions, this area is complex and it is possible that other conflicts arise that have not been thought of.

**3 b) Which aspects of the analysis that the SO will carry out for Government are most exposed to a potential conflict of interest? Please explain your reasoning.**

The analysis is the means by which conflicts of interest may be acted on and not in itself a cause of the conflict. The cost advice provided to Government is a crucial area of influence in respect of CfDs. For the capacity market, any advice on locational requirements for capacity would be a key area. If appropriate business separation is put in place then the ability for the EMR agent function to be able to influence the analysis to benefit other related businesses will be restricted.

**3 c) Do you agree with our conclusion that the main potential for synergies is between the SO and the EMR role? If not, please explain your reasoning.**

We are uncertain that there are significant synergies. There doesn't appear to be much that the SO can achieve in terms of synergies between the CfD and traditional SO role. There may be some benefit from the ability for the SO to commission analysis which could be helpful across its roles, such as on improved wind forecasting. Where such synergies are proven to exist then specific provision could be made for the sharing of this information between the roles. Indeed, the above example would be a suitable candidate for sharing amongst the wider market.

Similar skills might be needed to analyse reserve and capacity requirements. However, they are not the same product and require analysis on different timescales. They therefore should be assessed independently from each other.

**4 a) Do you think that all the potential conflicts of interest and synergies arising from an ability to exercise discretion have been identified? If not, please explain your reasoning.**

As with our answers to other similar questions, this is a complex area and it would be risk to assume that you could predict all instances where a conflict of interest may arise.

**4 b) Which potential areas of discretion present the most risk of conflicts of interest?**

It depends on the level of discretion that it awarded to the SO. We agree that discretion should be removed wherever possible. We would be concerned if the SO had discretion over who to award contracts to, for instance in order to take into account the effect of this on constraint management.

**4 c) Do you agree with our conclusion that the main potential for synergies is between the SO and the EMR role? If not, please explain your reasoning.**

We are uncertain as to the synergies which could be provided. The main synergies available from giving the EMR delivery role to the SO come from organisational benefits such as shared services and being able to draw on employees with relevant expertise. It is not clear that there are significant synergies to be gained from the EMR agent role working with the other SO roles particularly for the CfD element of EMR. There has been some discussion of the ability for the SO to optimise the mix of contracts issued under EMR and the services procured elsewhere in its more traditional role. For this to happen, the SO would have to be allowed some discretion over the contracts it awards.

As potential investors in new development projects this concerns us. When we apply for a CfD or capacity contract we want to understand the basis on which that contract might be awarded and the likelihood of the application being successful. If it is judged also on the basis of whether it provides cheap standing reserve or solves a constraint, then it will be very difficult for us to assess the risks associated with our application, as well as developing generation options required to back the application.

We believe that the EMR delivery function should as a default act independently of other EMR roles, unless specific synergies can be demonstrated to exist.

**5 a) Do you agree with the assessment of the relative immateriality of the potential conflicts between the EMR role and the SO?**

As we mention above in our response to Q1a), there is a significant potential materiality associated with the SO role which has not been properly reflected in the analysis.

**5 b) Do you agree that any potential conflicts with other activities including the electricity TO and businesses operating under mainly competitive conditions have the potential to be material?**

Yes.

**5 c) What further analysis could be carried out to determine the materiality of the conflicts we have identified?**

This is not necessary. There is sufficient doubt to justify putting in place arrangements to ensure that the EMR and other SO/TO/competitive functions are kept separate. The focus of any analysis should be on identifying and quantifying any potential synergies. If there are real possibilities for achieving significant synergies then the business separation provisions can include specific arrangements to allow them to be realised.

**6 a) Do you think that conflicts of interest relating to access to information can be addressed through the design of EMR and EMR governance measures set out above? Please explain your reasoning**

In part, but not fully. It would be better to rely on business separation arrangements.

**6 b) Which of the additional mitigation measures set out under 'further mitigation measures' should be considered to address these conflicts of interest? Would anything else be necessary? Please explain your reasoning.**

There should be full business separation between the EMR agent role and other businesses of National Grid.

**7 a) Do you think that conflicts of interest relating to influence can be addressed through the design of EMR and EMR governance measures set out above? Please explain your reasoning.**

Scrutiny of the SO's analysis and transparency of this to stakeholders would provide some benefit in this respect. However, transparency arrangements must ensure that commercially sensitive information is not made widely available.

**7 b) Which of the additional mitigation measures set out under 'further mitigation measures' should be considered to address these conflicts of interest? Would anything else be necessary? Please explain your reasoning.**

Again, transparency of the process will help. It does not seem helpful to require the SO to produce an impact assessment of how different options might benefit its other businesses. Any such assessment should be undertaken by a third party not the party who might potentially benefit. However, as we mention in our responses to other questions, a more appropriate solution would be to ensure that adequate business separation provisions are in place.

**8 a) Do you think that conflicts of interest relating to discretion can be addressed through the design of EMR and EMR governance measures set out above? Please explain your reasoning.**

It can to some extent and we agree that the SO should be prevented from using discretion in its EMR role wherever possible.

**8 b) Which of the additional mitigation measures set out under 'further mitigation measures' should be considered to address these conflicts of interest? Would anything else be necessary? Please explain your reasoning.**

It is unclear where the appeal mechanism would appear in the process and whose decision would be appealed. If it is the decision of the Government then this process would presumably be semi judicial in nature and require a significant amount of effort and expenditure on behalf of any appellant. If it is of a National Grid decision then the appeal could be made to Ofgem or DECC with less formality and cost.

**9 a) Overall, will the design of EMR, the proposed governance arrangements and the existing regulatory framework be sufficient to mitigate the conflicts that we have identified? Please explain your reasoning.**

No. We believe that full business separation should be put in place between the EMR delivery agent function and all other National Grid businesses.

**9b) Are other mitigations also likely to be necessary? If so, please specify what and why.**

Full business separation as mentioned previously.

**9 c) Are business separation requirements (beyond restrictions on information flows) necessary?**

Yes.

**9 d) If business separation is necessary what entity should be subject to the ring fence?**

The EMR delivery agent role.

**9 e) What degree of business separation do you think would be necessary to mitigate conflicts of interest?**

The EMR role should be ring fenced to same extent that is required for distribution companies with associated generation and supply interests.

**9 f) How can we best protect the synergies between the EMR and SO roles when considering additional mitigation measures?**

Synergies should be identified and quantified first. If there are any then the process for achieving those synergies should be identified. The arrangements required to facilitate this can then be put in place on a case by case basis.

I hope that the above response proves helpful. Please contact me in the first instance on the above number should you wish to discuss this further.

Yours faithfully

Paul Jones  
Upstream Trading Arrangements Manager