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Department of Energy and Climate Change
3 Whitehall Place
London
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29th January 2013

Dear Sir/Madam,

Re: RES Response to Synergies and Conflicts of Interest arising from the Great Britain System Operator delivering Electricity Market Reform.

RES is one of the world's leading renewable energy developers working across the globe to develop, construct and operate projects that contribute to our goal of a sustainable future. We have a portfolio of low-carbon energy technologies and a range of services which together can meet demand from the industrial, public and commercial sectors on whatever scale.

RES has been an established presence at the forefront of the wind energy industry for over three decades. Our core activity is the development, design, construction, financing and operation of wind farm projects worldwide. With a portfolio of more than 5GW constructed and several thousand megawatts under construction and in development, RES continues to play a leading role in what is now the world's fastest growing energy sector. RES is also involved in the dedicated biomass, solar, offshore wind and wave and tidal sectors.

RES welcome the opportunity to respond to the consultation on Synergies and Conflicts of Interest arising from the Great Britain System Operator (SO) delivering the Electricity Market Reform's (EMR) Capacity Mechanism and Feed-in Tariff Contract for Difference (FiT CfDs).

In our previous response to the joint DECC and Ofgem open letter on synergies and conflicts of interest arising from the designation of the SO as the proposed delivery body we outlined two distinct delivery functions. We believe there are two distinct delivery functions of FiT CfDs and the Capacity Mechanism: administrative functions and advisory functions (Figure 1.). We were clear in our response that we did not agree with the proposal of combining the administrative and the advisory functions by allocating both to National Grid in its role as SO. National Grid and its subsidiary, Elexon, benefit from experience of managing high volumes of ancillary service, energy balancing contracts and BSC energy settlement processes which make them strong candidates to perform the administrative function. However, it is not in the same position of industry leadership in the field of the advisory functions, which could be performed by a number of organisations that are either public, private or not for profit.

Administrative Functions	Advisory Functions
Administer Contracts	Scenario Forecasting (volume and price by technology)
Administer Auctions	Planning
Reconciliation	EMR Policy Advice
Payments	Detailed technology economic analysis – modelling of the overall impact of technology costs, deployment potentials, capacity forecasts, Government objectives & system costs.
Credit Management	Monitoring the Administrative Functions
Reporting Against Objectives	
Monitoring Generators Compliance	

Figure 1.

In line with our previous response we have drafted this response with the knowledge that the Government will bundle the administrative and advisory functions together; we remain convinced that this approach is not in the best interest of the industry nor of the energy consumer. However, on the assumption that the Government does not see it fit alter its position, we have identified the measures we think should be implemented to minimise conflicts, ensure transparency and accountability.

The key points to note in our response are outlined below:

1. The design of the EMR governance measures to mitigate conflicts of interest need to be outlined in more detail. The missing detail on the mechanistic processes is concerning at this stage. Industry and investors are unable to have confidence that the mechanistic processes will mitigate all conflicts of interest at this stage as they are unable to be fully reviewed.
2. Furthermore, the limited detail and therefore assessment in this consultation, limit its value. Materiality will remain unknown until the final report, which may be too late to undertake all the required mitigation measures or if deemed necessary to seek another company to undertake any part of the delivery. A preliminary assessment only is conducted here, and given the potential ramifications of a conflict of interest the precautionary principle must be employed until proven otherwise.
3. By combining both the administrative and the advisory roles into a single body, there is a risk of creating a body that is unassailable in terms of capability and it becomes a de-facto decision maker by nature of its recommendations and yet lacks public accountability. This could significantly damage confidence of investors when investing in electricity generation projects in GB and consumers when having to support low carbon investment through their energy bills.
4. To provide the degree of confidence investors require the EMR delivery functions need to be ring-fenced by isolating the delivery function from all other parts of National Grid in a way that is both visible and legally enforceable. Measures must include:

- i. definition of role, responsibility and ring fencing requirements in licence conditions,
- ii. restriction on information flows from the EMR delivery function,
- iii. physical separation of hardware, facilities and premises, and
- iv. separation of employees and remuneration.

We support Option C, 2b (regulation of information flows, deeper and legal separations).

- 5. Additionally, there are limited synergies for National Grid to carry out the EMR delivery role in Northern Ireland. The delivery of EMR in Northern Ireland needs to be considered in more detail. It is not mentioned once in the whole consultation document.

RES are grateful for the opportunity to comment and look forward to the final report on conflicts, synergies and mitigations due in Spring 2013. We hope you take our comments on board and welcome any further contact in relation to this response, please contact David Handley at dave.handley@res-ltd.com or on 01923 299 370.

Yours sincerely,

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Chapter 5: Conflicts of interest and synergies

Question 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.

This is clearly a leading question and we do not agree. As stated above we believe there are two distinct delivery functions of FiT CfDs and the Capacity Mechanism: the administrative and advisory functions (Figure 1.). It is very hard to identify the precise material conflicts arising from the electricity SO having access to EMR related information at this stage. However the risks exist and this could ultimately influence the provision of grid, balancing and other SO services in a way that would not have happened if it was not in receipt of EMR related information. Similarly whether this has adverse or beneficial implications is hard to establish at this point in time as it depends on how that information is used. Any material conflicts would delay investment under the EMR which would not be desirable at this stage. DECC have chosen National Grid to carry out the EMR delivery roles without appropriate consideration of other entities which could have undertaken the role, or undertaken part of the role. It appears as if the decision to appoint National Grid as the delivery body was made in 2010, regardless of what conflicts of interest are identified, material or otherwise.

The conflicts of interest which have the potential to arise given the information that National Grid will have access to and the influence and discretion it will have under the proposed advisory functions of EMR is likely to be material in our opinion. However, how material is difficult to define at this stage when so much detail remains unknown. It is stated in the consultation that:

“We have not identified any likely material conflicts relating specifically to information access in relation to the electricity SO business.¹”

We do not believe there is sufficient clarity to make this claim, for example there are likely to be conflicts of interest arising from balancing the system and National Grid allocating projects for both the Capacity Mechanism and FiT CfDs.

Additionally, there may be further conflicts of interest which arise in the future which are not foreseen. Furthermore, as a private body the National Grid has a duty to its shareholders to maximise shareholder value and shareholder influence could become apparent in the future. Therefore National Grid's role should be kept under regular review and action should be taken if needed in the future.

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.

This consultation document assumes much more synergy in the National Grid acting as the delivery body for the EMR than is actually presented and does not adequately consider conflicts as discussed in response to question 1a above. Little detail is presented in the consultation on the actual financial benefits of these synergies, as the cost to National Grid as the delivery body is not yet known. No other organisations were offered the opportunity to estimate their cost to provide the delivery body functions for the EMR so no comparison can be made.

¹ Point 73, Page 28, DECC and Ofgem, Synergies and Conflicts of Interest arising from the Great Britain System Operator delivering Electricity Market Reform Consultation Document, December 2012, http://www.decc.gov.uk/en/content/cms/consultations/coi_emr/coi_emr.aspx

Regarding the administrative functions of FiT CfDs and the Capacity Mechanism, National Grid has experience of managing many related processes to the proposed functions under the EMR which will assist in their management of these mechanisms. There will be substantial knowledge at National Grid from the current processes they undertake and they will also have similar systems already in place. These two synergies will reduce development time and ultimately reduce costs for consumers. Consumers will benefit from making the best possible use of existing expertise in areas such as the balancing mechanism and interconnection.

However, the presence of synergies can also be taken in a less positive manner, as existing practices and processes can equally obstruct the consideration of more efficient and effective solutions and maintain processes largely due to institutional bias. Rather than fully evaluating alternative business models that may be more effective but require changes to business processes. We would argue that this has already been demonstrated in the choice of the metering point and in the treatment of negative market processes and the apparent lack of consideration for onsite generation.

National Grid is not the de-facto provider of the EMR delivery service. A robust tender process would have enabled all possible synergies and gaps in National Grid's ability to be identified in advance of the commencement of EMR, discussed in more detail in response to question 1e below. Furthermore, along with the SO synergies there are risks as so much technical expertise will be retained in-house. When completing its advisory functions, this level of technical expertise will make it difficult for others to robustly challenge National Grid if they have a contrasting view. To mitigate this risk all the data which feeds into model and the model platform itself should be publically available and fully transparent, discussed further in response to questions 6 to 9 below. Therefore, National Grid's calculations, assumptions and views can be fully tested to identify their robustness.

It is stated in the consultation that:

"The main benefit with the SO arises from access to information that would enable it to lower its balancing costs²."

However, we do not believe this to be a substantial synergy. This information could be provided by whoever carries out the EMR delivery functions by National Grid.

Furthermore, there are limited synergies for National Grid to carry out the EMR delivery role in Northern Ireland. The delivery of EMR in Northern Ireland needs to be considered in more detail. It is not mentioned once in the whole consultation document.

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.

No, the potential for conflicts and synergies arising from the electricity Transmission Owner having access to EMR related information is not limited. From reviewing the proportionality of National Grid's profits as shown in figure 2 of the consultation³ and the conclusion in the consultation that "conflicts that pertain to the TO electricity business have the potential to be particularly financially material." The potential for conflict in the EMR delivery functions of the Capacity Mechanism and

² Point 75, Page 28, DECC and Ofgem, Synergies and Conflicts of Interest arising from the Great Britain System Operator delivering Electricity Market Reform Consultation Document, December 2012, http://www.decc.gov.uk/en/content/cms/consultations/coi_emr/coi_emr.aspx

³ Figure 2, Page 17, DECC and Ofgem, Synergies and Conflicts of Interest arising from the Great Britain System Operator delivering Electricity Market Reform Consultation Document, December 2012, http://www.decc.gov.uk/en/content/cms/consultations/coi_emr/coi_emr.aspx

FiT CfDs are potentially the most applicable to this area of the business. Of particular concern is the potential interaction between policy advice on FiT CfDs strike price and the need for transmission system infrastructure in England and Wales (a matter that is clearly of interest to National Grid shareholders). Particularly with the potential to either overlook the potential of distributed energy or even over emphasise the associated costs.

An additional material conflict is also highlighted in the consultation document:

“Exerting influence to favour generation solutions generally over demand-side reduction solutions (that require less network use) might further enhance the profitability of the electricity transmission network in England and Wales. Given electricity transmission activities make a significant contribution to the overall profits of National Grid, this conflict may have the potential to be material.”⁴

National Grid will have access to information about Government policy intentions and also industry information about generation projects which will not be accessible to other industry participants. This is likely to be a material conflict of interest and a potential market advantage.

As a private body the National Grid has a duty to its shareholders to maximise shareholder value. This may, at times, conflict directly with its duty in an advisory capacity to provide impartial advice targeted at delivering the optimum GB transmission system (ultimately paid for by the GB consumer) to the government.

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.

We agree that there is less potential for conflicts between the operation in the gas distribution market and the role in National Grid. However, it should be recognised that there will be potential conflicts in the Capacity Mechanism, and the determining of when the first auctions should take place.

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?

National Grid, as a private company ultimately responsible to its shareholders, will be providing analysis to Government on which to base its decisions on rules and parameters such as the FiT CfDs strike price. Policy approach and translating policy objectives into delivery must remain within Government. The Government needs to be clearly accountable for setting the strike price for FiT CfDs and delivering the UK low carbon and renewable targets within the Levy Control Framework. Therefore, as discussed above National Grid should only undertake the administrative functions of FiT CfDs and the Capacity Mechanism, the advisory functions should be carried out by a separate body.

A robust tender process would have enabled all possible synergies and gaps in National Grid's ability to be identified. In order to achieve an effective tender process in the future, the data and algorithms necessary to complete this role should remain the property of the government and only assigned to a delivery organisation for a defined period of time. The assignment of the administrative role to National Grid in the delivery of FiT CfDs and the Capacity Mechanism should

⁴ Point 81 (page 33), DECC and Ofgem, Synergies and Conflicts of Interest arising from the Great Britain System Operator delivering Electricity Market Reform Consultation Document, December 2012, http://www.decc.gov.uk/en/content/cms/consultations/coi_emr/coi_emr.aspx

be exposed to regular competitive tendering. This will encourage efficient management of the proposed EMR functions.

By combining both the administrative and the advisory roles into a single body, there is a risk of creating a body that is unassailable in terms of capability and it becomes a de-facto decision maker by nature of its recommendations. This could significantly damage confidence of investors in electricity generation projects in GB.

The EMR functions will increase both the complexity of National Grid's role and the dependence of the GB energy sector as a whole on National Grid's effective performance of its role. It is not just the GB energy sector which will be increasingly dependent on the National Grid but all energy consumers, therefore the whole nation will be dependent on one body to successfully carry out the multiple functions placed upon it. As with the vertical integration of only six big energy companies at present, the National Grid will become too big to fail. However, as a shareholding company this should not be the case.

The choice made to appoint National Grid as the delivery body for the EMR because of the apparent synergies may actually limit innovation and increase costs. Limiting involvement from other companies creates a barrier to innovation which could reduce costs. The ability to separate and remove either all or parts of FiT CfDs or Capacity Mechanism functions must be devised. Furthermore, careful consideration needs to be given as to what the process will be if National Grid encounters difficulties, in particular, the potential need to transfer responsibility to another delivery body.

The delivery functions for FiT CfDs and the Capacity Mechanism should remain property of the Government but for a third party to lease and administer e.g. the SO (National Grid). Therefore, all the data and processing functions remain property of the Government but the SO leases the operational functions and associated revenue. Transferability is important given the historic record of Government creating favoured quangos and then these being cut if they fall out of favour, such as the Carbon Trust.

Question 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.

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

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

Question 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.

We believe all the major potential conflicts of interest and synergies arising from an ability to exert influence have been identified.

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.

As outlined in response question 1c, it is the potential for conflicts arising from the electricity Transmission Owner having access to EMR related information given the proportionality of National Grid's profits in this area and the conclusion in the consultation that "conflicts that pertain to the TO electricity business have the potential to be particularly financially material."

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.

As discussed in response to question 1b, regarding the administrative functions of FiT CfDs and the Capacity Mechanism, National Grid has experience of managing many related processes to the proposed functions under the EMR which will assist in their management of these mechanisms. However, as discussed in response to question 1e above, without a robust tender process neither all synergies nor alternative providers can be identified.

Question 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.

No, all the major potential conflicts of interest have not been identified and outlined in sufficient detail. For example if National Grid undertakes the advisory functions they will have the ability to exercise discretion under EMR on the type, location and volume of new generation. The type of plant developed will have a direct impact on their role as the SO. Therefore, it is important that political intentions are not undermined due to the reluctance of a SO that may perceive commercial risk associated with particular types of generation. To mitigate this risk the scheme must be designed robustly limiting the discretion National Grid will have, this is discussed in more detail in response to question 6a below.

However, in the previous joint DECC and Ofgem open letter on synergies and conflicts of interest, the conflict potential was highlighted for the SO to "influence the choice of generation projects that enable it to deliver the required output under RIIOT1 for lower levels of transmission capital expenditure or with lower risk of overspend, compared to alternative generation projects including those that might have influenced their RIIOT proposals". As a developer of projects this is still of very great concern, currently the ability to secure a grid connection is a critical milestone. The introduction of grid connection as eligibility criteria for FiT CfDs alongside this potential conflict of interest adds significant uncertainty and risk to projects which will drastically undermine investor confidence. As National Grid will have input into the connection agreement, particularly if the project is transmission connected.

A further area which we do not think has been suitably picked up or addressed is the risk of institutional bias to an existing system or process which may be to the disadvantage of a particular group or class of generation. The obvious example is that National Grid knows the institutions and the structure that determine large transmission based generation and base system and structures on that predisposition. As a result they may fail to fully explore and take advantage of other system that are employed internationally to encourage the integration of distributed generation and non-dispatchable generation (such as the data and central dispatch, balancing capability that could be achieved through SCADA data flows).

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

The area which represents the most risk of conflict of interest in terms of discretion is outlined in response to question 4a above.

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.

The main potential for synergies is between the SO and the EMR role. However, the synergies outlined could be achieved to a certain degree by another body undertaking the EMR delivery role and providing the information to the SO.

Question 5:

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

The table below outlines our assessment of National Grid's ability to act upon a conflicting interest having the potential to lead to conflict or synergy, in contrast to figure 5 presented in the consultation document. Where we believe a conflict or synergy has the potential to materialise it is denoted with a tick.

Conflict/Synergy	Ability	Activity	Activity
		TO Electricity	SO Electricity
Conflict	Information	√	√
	Influence	√	√
	Discretion	√	√
Synergy	Information	√	√
	Influence	?	√
	Discretion	?	√

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?

Regardless of the materiality of the potential conflicts between the EMR role and National Grid it should not be ignored or belittled. Just because profitability to National Grid is (perceivably) low, this does not mean they will not and should not act upon it. Incentive to act upon a conflict will not only be driven by return value and it should not be possible to act upon it even if the return is low. The return value may be low but it could be attractive at certain points to the company or to certain people in the company. The deterrent needs to be strong enough to prohibit any action in the first place. Furthermore, if the potential conflict exists National Grid risks opening itself up to challenge from industry. This is contradictory to ultimate aim of the entire synergies and conflict of interest project undertaken by Ofgem and DECC, which is for industry and investors to have confidence in National Grid as the delivery body for the EMR.

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

As stated in the document:

“This consultation does not assess how great that benefit may be. We will seek to carry out further analysis on the materiality of these conflicts ahead of the final report.”⁵

The limited detail and therefore assessment in this consultation, limits its value. Materiality will remain unknown until the final report, which may be too late to undertake all the required mitigation measures or if deemed necessary to seek another company to undertake any part of the delivery. It is very concerning that a preliminary assessment has only just been completed whilst the Energy Bill has entered the house which effectively embeds the role of National Grid

Chapter 6: Mitigation measures

Question 6 (Information Mitigation):

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

To a certain extent conflicts of interest relating to access to information can be addressed through the design of EMR and EMR governance measures as set out in the consultation. We support the steps proposed by DECC to mitigate conflicts faced by National Grid through existing regulation, management of information, high levels of transparency and limits on the discretion of the EMR delivery function.

However, the design of EMR and EMR governance measures needs to be outlined in more detail. Industry and investors are unable to have confidence that the mechanistic processes will mitigate all conflicts of interest at this stage as we cannot review them. National Grid will need and want the governance and associated mechanistic processes to be watertight, otherwise they will be open to challenge from industry which will damage confidence in their other regulated roles and their competitive businesses.

For example, the process which will ensue when the Levy Control Framework budget is constrained needs to be outlined in robust detail. The timeline and process needs to be fully outlined so all industry participants can have a clear indication of the place of their project in the allocation process and make project decisions accordingly. Of particular importance to this process is the process that National Grid will apply to any allocation mechanism and how to ensure that such processes are free from institutional bias.

Furthermore, under the measure “high levels of transparency” National Grid needs to be very open and transparent, with all the data which feeds into model and the model platform should be publically available and fully transparent. The information which feeds into policy advice should be the subject of rigorous public consultation on an ongoing basis. Therefore, National Grid’s calculations, assumptions and views can be fully tested to identify their robustness. There will be concerns around confidentiality of the data but the data can be aggregated to mitigate this risk. Failure to deliver this openness and transparency will result in damage to investor confidence in the decision making process. It will also increase the need for stronger independent scrutiny of long term planning and projections.

As a general principle the process should be sufficiently open and transparent such that it can be used to evaluate the financial implications of a change of law provision.

⁵ Point 44, page 17, DECC and Ofgem, Synergies and Conflicts of Interest arising from the Great Britain System Operator delivering Electricity Market Reform Consultation Document, December 2012, http://www.decc.gov.uk/en/content/cms/consultations/coi_emr/coi_emr.aspx

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.

In our view the steps outlined to address conflicts of interest relating to access to information do not go far enough to provide the confidence to attract the required investment for generation and transmission. They also provide insufficient detail which should not be the case at this late stage in the delivery of the EMR.

Currently National Grid has a number of affiliate businesses, such as Grain LNG and National Carbon Limited that may be in a position to benefit from the decisions taken by National Grid in their advisory capacity. To avoid any potential conflict of interest, these commercial activities need to be fully separated, as they current are for National Grid’s SO and TO operations. This division is more complex for large infrastructure projects such as the bootstraps, OFTOs or interconnectors where competition could in theory be introduced and National Grid would have significant competitive advantages.

Given the unknown potential conflicts of interest, benefits of synergies and mitigations measures at this stage full separation of the EMR delivery function from all of National Grid’s other activities is required. To provide the degree of confidence all industry participants and investors require the EMR delivery function needs to be ring-fenced by:

1. isolating the delivery function from all other parts of National Grid to separate it from all potential conflicts
2. the ring fence should be strong including:
 - i. definition of role, responsibility and ring fencing requirements in licence conditions,
 - ii. restriction on information flows from the EMR delivery function,
 - iii. physical separation of hardware, facilities and premises, and
 - iv. separation of employees and remuneration.
3. establishing the EMR delivery function as a separate legal entity whose directors would act independently of other National Grid businesses.

At a later stage in the EMR when synergies arise and more communication within National Grid businesses is required the separation restrictions could be relaxed on a case by case basis. It is preferable and easier at this stage to apply the most onerous business separation of Option C, 2b (regulation of information flows, deeper and legal separations) and relax the restrictions at a later date if deemed necessary. Once the EMR is operational it will be possible for the full financial benefits of synergies to also be assessed and fully consulted upon through a change control process. Full separation will also help to mitigate the risk of unintended consequences.

There is a strong overlap between the additional mitigation measures to cover the designated mitigation types: information, influence and discretion. This can be seen in our response to questions 7b and 8b below. Additional to the ring fencing of the EMR delivery functions in order to mitigate information conflicts of interest, there needs to be the following:

- **Strong Regulations** - Regulations will need to define the way in which National Grid will operate and what will happen if it is breach of those regulations. In order to provide a sufficient deterrent.
- **Open and Transparent Communication** - All steering group minutes and major points of communication between the Government and National Grid relating to its advisory function should be open to public scrutiny. Moreover, the National Grid should be subject to the same Freedom of Information requests as the rest of government and government agencies when it comes to their advisory role.

- **Process for Change** - Regulation would also need to be adaptable over time and as issues arise. How Ofgem or DECC will enforce the regulations imposed upon National Grid and manage non compliance needs to be fully outlined from the beginning.
- **Independent Board of Governance** - DECC, Ofgem, nominated industry participants and National Grid could create a board to monitor the arrangements and enforce the regulations. The minutes of this board and supporting submissions should be placed in the public domain.
- **Access to Information** - Management of access to and use of information will need to be carefully monitored and audited with penalties for breach. This mitigation measure should definitely be taken forward if the SO is chosen to carry out all the EMR delivery functions.

Question 7 (Influence Mitigation):

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.

Please see response to question 6b above, to provide the degree of confidence investors require the EMR delivery function needs to be effectively ring-fenced.

All the mitigations set out under the further mitigation measures⁶ should be implemented. Furthermore we agree an appeals process is definitely required⁷. There needs to be a robust mechanism in place for generators to challenge the SO's advice. This challenge will need to be made to an independent body. In line with this we also outline a process for change in response to question 7b below.

RES believe there should be no "incentives" on the SO to "synergise" its role⁸. RES considers that there should be specific requirements and associated revenue incentives applied through effective regulation. The incentive to create appropriate synergies would flow naturally as part of achieving efficient operation as a means of optimising revenue incentives. The role of National Grid needs to be clear with regards to how the policy objectives set by Government interrelate with the funding incentives set by OFGEM and the delivery plan devised by National Grid. For example smart-grids and improved demand-side response may not be prioritised in place of other revenue incentivised activities as prescribed under RIIO-T1.

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.

⁶ Point 188, Page 44, DECC and Ofgem, Synergies and Conflicts of Interest arising from the Great Britain System Operator delivering Electricity Market Reform Consultation Document, December 2012, http://www.decc.gov.uk/en/content/cms/consultations/coi_emr/coi_emr.aspx

⁷ Point 195, Page 46, DECC and Ofgem, Synergies and Conflicts of Interest arising from the Great Britain System Operator delivering Electricity Market Reform Consultation Document, December 2012, http://www.decc.gov.uk/en/content/cms/consultations/coi_emr/coi_emr.aspx

⁸ Point 190, Page 44, DECC and Ofgem, Synergies and Conflicts of Interest arising from the Great Britain System Operator delivering Electricity Market Reform Consultation Document, December 2012, http://www.decc.gov.uk/en/content/cms/consultations/coi_emr/coi_emr.aspx

Additional to the ring fencing of the EMR delivery functions in order to mitigate influence conflicts of interest, there needs to be:

- **Scrutiny of Advice** - The potential mitigation measure of “scrutiny of the advice that the SO provides to Government on the key parameters of the FiT CfDs and Capacity Mechanism” is absolutely necessary if National Grid is to undertake the advisory functions of FiTs CfDs and the Capacity Mechanism. Without this measure it will cause significant damage to investor confidence. Independent scrutiny should be applied to all the data and comments that the SO provides to DECC.
- **Review** - For both the administrative and advisory functions there needs to be a robust review process by an independent auditor. Such as Ofgem or DECC to verify the analysis and conclusions. With the additional possible consultation with industry when necessary. It is stated in the consultation that “There may also be a role for Ofgem to scrutinise the SO’s analysis and assess the impacts of the analysis on National Grid’s businesses. ” However, it does not have to be Ofgem which undertakes this role an independent auditor could also undertake this work. The work could be bid for through a robust tender process and the entity could therefore change providing more security.
- **Strong Regulations** - Regulations will need to define the way in which National Grid will operate and what will happen if it is breach of those regulations. In order to provide a sufficient deterrent.
- **Open and Transparent Communication** - All steering group minutes and major points of communication between the Government and National Grid relating to its advisory function should be open to public scrutiny. Moreover, the National Grid should be subject to the same Freedom of Information requests as the rest of government and government agencies when it comes to their advisory role.
- **Process for Change** - Regulation would also need to be adaptable over time and as issues arise. How Ofgem or DECC will enforce the regulations imposed upon National Grid and manage non compliance needs to be fully outlined from the beginning.
- **Independent Board of Governance** - DECC, Ofgem, nominated industry participants and National Grid could create a board to monitor the arrangements and enforce the regulations. The minutes of this board and supporting submissions should be placed in the public domain.

Question 8 (Discretion Mitigation):

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.

The details on the limits of the discretion National Grid will hold needs to be outlined in detail. Designing the scheme appropriately can remove conflicts of interest in terms of the administrative function i.e. if the rules on allocation and payments FiT CfDs are detailed in a sufficient manner National Grid will have limited ability to take advantage of any conflicts of interest. We welcome seeing further detail on:

“We are limiting the scope for discretion in these functions by designing mechanistic processes which will be clearly and transparently set out.”⁹

⁹ Point 86, Page 35, DECC and Ofgem, Synergies and Conflicts of Interest arising from the Great Britain System Operator delivering Electricity Market Reform Consultation Document, December 2012, http://www.decc.gov.uk/en/content/cms/consultations/coi_emr/coi_emr.aspx

The design and process need to be fully consulted upon, in a similar way to which Ofgem consult on their generator guidance under the RO, FiTs and RHI. However, the design and process should be more robust than the current Ofgem guidance, as Ofgem retain a great deal of discretion which the SO should not have.

However, it is unclear how limiting discretion through design can be achieved under the advisory functions. The Governance Framework should provide this protection but it is unclear from this consultation how and therefore if the Governance Framework can achieve this. The framework proposed needs to be clearly defined. How the National Grid will engage with and consult with industry when formulating its positions and recommendations needs to be defined.

If National Grid is to undertake the advisory function it will be providing information to DECC on matters in which it has limited or no experience. These will include estimation of technology costs (including project specific costs such as cost of finance) and deployment potential. The means by which National Grid obtains this information and how this information is applied in delivering strike price advice must be the subject of public scrutiny before it is implemented. Policy approach and translating policy objectives into FiT CfD strike prices have to remain within Government. There also needs to be a clear process for industry to input and challenge the setting of strike prices as is currently the case with the RO banding review.

Please also see our response to question 6b above, to provide the degree of confidence investors require the EMR delivery function needs to be effectively ring-fenced.

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.

Additional to the ring fencing of the EMR delivery functions in order to mitigate discretion conflicts of interest, there needs to be:

- **Review** - For both the administrative and advisory functions there needs to be a robust review process by an independent auditor. Such as Ofgem or DECC to verify the analysis and conclusions. With the additional possible consultation with industry when necessary.
- **Strong Regulations** - Regulations will need to define the way in which National Grid will operate and what will happen if it is breach of those regulations. In order to provide a sufficient deterrent.
- **Open and Transparent Communication** - All steering group minutes and major points of communication between the Government and National Grid relating to its advisory function should be open to public scrutiny. Moreover, the National Grid should be subject to the same Freedom of Information requests as the rest of government and government agencies when it comes to their advisory role.
- **Process for Change** - Regulation would also need to be adaptable over time and as issues arise. How Ofgem or DECC will enforce the regulations imposed upon National Grid and manage non compliance needs to be fully outlined from the beginning.
- **Independent Board of Governance** - DECC, Ofgem, nominated industry participants and National Grid could create a board to monitor the arrangements and enforce the regulations. The minutes of this board and supporting submissions should be placed in the public domain.

Question 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, the proposed governance arrangements and the existing regulatory framework need to be more robust to appropriately mitigate conflicts of interest. It is stated in the consultation that:

“The objective is not to eliminate the conflicts entirely, but to reduce the risk of conflicts to an acceptable level and manage the risk that they could arise.”

We disagree with this conclusion, all conflicts of interest need to be eliminated allowing any conflicts of interest to arise no matter how small will have detrimental consequences to the whole of the EMR, it will increase risk and could severely damage investor confidence. As discussed in response to question 5b above. If a conflict of interest can be mitigated against, no matter how small the conflict may be, something should be done.

It is also insufficient to simply “aim to have all mitigation measures in place by the time EMR is operational”. It is vital all necessary mitigation measures are adequately in place by the time the EMR is operational.

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

As discussed in response to question 6b above, more robust ring-fencing of arrangements is required.

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

Yes, as discussed in response to question 6b above, robust ring-fencing of EMR activity is required.

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

The entire EMR delivery function should be effectively and robustly ring-fenced from all other business activities, Option C, 2b (regulation of information flows, deeper and legal separations) proposed in the consultation.

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

As discussed in response to question 6b above, more robust ring-fencing of arrangements is required. Legal separation of the EMR delivery function coupled with:

- restriction on information flows from the delivery function,
- physical separation of hardware, facilities and premises, and
- separation of employees and remuneration.

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

Synergies can be retained when implementing all the mitigation measures proposed above. As long as the delivery functions under the EMR remain open and transparent through publication of all non-confidential information. Furthermore, beneficial data and training can be provided from other National Grid functions to the EMR delivery function as a fully transparent one way process, which can be accessed by all market participants.