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Your Ref: URN12D/444

Dear Sir or Madam

RWE response to DECC and Ofgem consultation on “Synergies and Conflicts of Interest arising from the Great Britain System Operator delivering Electricity Market Reform”, 29th November 2012.

We set out below the RWE response to the DECC and Ofgem consultation on “Synergies and Conflicts of Interest arising from the Great Britain System Operator delivering Electricity Market Reform” published on 29th November 2012. This response is provided on behalf of the RWE group of companies, including RWE Npower plc, RWE Supply & Trading GmbH and RWE Npower Renewables Limited.

As stated in our previous submission on this topic the roles and responsibilities of National Grid Electricity Transmission plc (National Grid) as the Electricity Market Reform (EMR) Delivery Body should be clearly defined under the terms of its Transmission Licence and separate from its System Operation and Transmission Ownership activities. A new section in this licence is, therefore, required that relates specifically to EMR with licence conditions that set out the duties and responsibilities of National Grid in performing the EMR functions. In addition, licence conditions should set out the requirement to develop and maintain administrative arrangements and industry Codes that relate to proposed arrangements for Contract for Differences and the Capacity Mechanism.

It remains our belief that that the Great Britain (GB) System Operator should not undertake any specific role with respect to National Grid's EMR duties. We remain concerned about the potential for conflicts of interest with respect to National Grid undertaking the EMR duties while acting as System Operator and Transmission Owner.

We note that DECC highlight potential synergies between the system operator role and the EMR functions particularly with regard to undertaking

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an analytical role while performing the System Operator functions¹. While we recognise that there may be overlap of certain functions we do not believe that the System Operator is the “right choice to deliver EMR”. We are concerned that there is a danger that the System Operator’s enhanced role under EMR carries with it the risk that the EMR functions may distract from the management of the GB transmission system. As a case in point, the capacity mechanism itself may create incentives on market participants and the System Operator that impact on the normal function of the electricity balancing role, particularly where the distinction between reserve and capacity services are blurred. Therefore we strongly urge the Government to consider the separation of EMR functions from the normal System Operation activities to ensure that appropriate commercial incentives with respect to the separate activities are maintained.

In considering the role of the System Operator under EMR it is essential that the industry has a clear understanding of the functions that are required to deliver EMR. At this late stage in the process vital elements of the proposed arrangements remain unclear such as the detailed design of the capacity mechanism and its interaction with the provision of reserve services. It is essential that these issues are resolved as soon as practicable in order to assess the potential for conflicts of interest. Given our concerns however, it would make sense if there was clear separation between the various EMR functions (Delivery Plan management; CFD administration; Capacity Mechanism administration etc) in order to take a view on the efficiency of the potential arrangements. It is possible that certain functions are more readily associated with the System Operator than others, where an arms length relationship could be more appropriate. For example, the SO could provide forecasting services but not be responsible for the capacity mechanism procurement process, which could be outsourced to a third party.

A further consideration is the development of appropriate governance arrangements for all aspects of EMR. We are expecting for example, the settlement arrangements for both the CFD and the Capacity Mechanism are subject to industry codes, with governance arrangements similar to those under other industry Codes (for example, the Balancing and Settlement Code). We also believe that the Capacity Mechanism should be subject to a detailed set of rules that are set out in a Capacity Code. This should for example, provide for the capacity auctions, the inspections regime and the penalty arrangements. Extensive rules surrounding capacity mechanism have been developed in other jurisdictions (such as the PJM capacity mechanism). We believe that such arrangements are required for the GB capacity mechanism.

Our answers to the specific questions raised in the consultation are included in an attachment to this letter.

If you wish to discuss any aspect of our response, please do not hesitate to contact me.

Yours sincerely

Bill Reed
Market Development Manager
RWE Supply & Trading GmbH

¹ Annex D Institutional Framework: Delivering EMR, DECC, November 2012

Attachment 1: RWE Response to the Specific Consultation Questions

1. Information – conflicts and synergies (monopoly conditions)

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.

We do not agree that there are unlikely to be material conflicts arising from the electricity System Operator having access to EMR related information. We have already seen concerns with respect to delivery of commercial confidential information to the System Operator as part of the call for evidence to set strike prices under the CFD arrangements. In part this reflects a lack of understanding of how the EMR arrangements will work in practice, poor definitions of the role and duties of the System Operator and insufficient testing and trialling of the arrangements.

While initial teething problems may be resolved, there remain more fundamental concerns about information provision to the System Operator in the application of the EMR functions. These include, but are not limited to:

- the submission of cost information to a body that will set strike prices, provide advice to Government and issue contracts; and
- the submission of capacity data to a body that is responsible for running a capacity auction while undertaking a role of contracting for similar capacity under reserve provision.

We believe that careful consideration is required in the design of the EMR functions and the potential means by which such conflicts of interest are managed.

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 do not agree that there is a significant potential for synergies as a result of the electricity System Operator having access to EMR related information. Indeed we would be concerned if this were to occur. We believe that information submitted to the System Operator for the purpose of balancing the system should be distinct from information provided to the EMR functions with respect to CFDs and the Capacity Mechanism. For example we would be concerned if commercially confidential information on availability or reliability of plant available to the System Operator as part of the reserve bidding process influenced decisions on the award or management of contracts under the capacity mechanism. We believe that a better understanding of the EMR functions is required prior to determining whether these concerns can be addressed through the design of the arrangements.

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 accept that there is limited scope for the System Operator to benefit directly from the management of the EMR functions by, for example, seeking to profit through balancing activities through the management of the capacity arrangements. However, since there is limited information at this stage on the precise duties and responsibilities of National Grid under the EMR functions it is difficult to determine whether such conflicts may exist. It is essential that the scope and scale of the EMR functions is properly defined and there is sufficient testing and

trialling of the proposed arrangements in order to assess whether there are inherent conflicts of interest in the arrangements.

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.

It is unclear at this stage whether there are potential conflicts with gas distribution, gas transmission and gas system operation arising from access to EMR information. However, given the increasingly important role of gas fired generation in balancing the system, there is potential for interactions between the capacity mechanism and the provision of balancing services. Consequently we believe that there is a strong case for ensuring separation between information provided for the purpose of EMR and information provided for the purpose of system operation. We note however, that publically available information provided under REMIT will already facilitate system operation and the key issue is additional commercial information available under EMR and the capacity mechanism.

f) 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?

As noted in the answers to the previous question in this section it is unclear at this stage as to the range of potential issues that may arise with regard to access to information under the EMR functions given that detailed testing and trialling of the arrangements has not yet occurred. We believe it would be appropriate to review the information provisions under EMR once such testing and trialling has been completed.

2. Information – conflicts and synergies (competitive conditions)

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.

We remain unclear as to the scale and extent of possible conflicts of interest associated with competitive businesses given the lack of detailed information on how the EMR functions will work in practice. Further work is required in this area. However, the starting positions should be that there is clear separation between the EMR functions and National Grid competitive businesses (including system operation).

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

It is clearly essential that commercially sensitive information submitted as part of the EMR process is restricted in circulation and unavailable to National Grid's competitive businesses.

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

As noted in the answers to the previous question in this section it is unclear at this stage as to the range of potential issues that may arise with regard to National Grid's competitive businesses associated with the undertaking of EMR functions. Detailed testing and trialling of the arrangements is required to understand whether this is a real problem. We believe it would

be appropriate to review the information provisions under EMR once such testing and trialling as been completed.

3. Influence – conflicts and synergies

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.

Given that the full scale and scope of the EMR functions under National Grid's licence are yet to be defined it is difficult to determine whether all the major potential conflicts of interest have been identified. We note, for example, that the detailed arrangements for auctioning under the capacity mechanism and the inspections regime have yet to be determined. We remain concerned that there are risks associated with the system operator undertaking these EMR functions. Consequently clear business separation is required between the EMR functions and the system operator activities. In addition, National Grid will play a pivotal role in providing advice to Government in a number of areas and it is essential that such advice is unbiased, objective and represents a reasonable view of the future development of the GB electricity market. Consequently provisions are required to ensure that this is the case.

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.

There are a number of aspects of the analysis which potentially gives rise to conflicts of interest including:

- Operating capacity auctions while managing system operation, with outcomes recommended to ministers that may be influenced by decisions over National Grid's view of the entire energy market;
- Recommending acceptance of certain bids while in possession of information associated with Transmission connection conditions or commercially sensitive data obtained through the capacity mechanism (e.g. reliability data); and
- Providing advice on the Delivery Plan including key assumptions and sensitivities when in possession of certain strategic data in the competitive businesses which may validate or invalidate certain assumptions.

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 accept that there may be for synergies between the SO and EMR role for certain functions such as producing the Delivery Plan. We do not believe that such synergies exist with respect to undertaking certain administrative roles under EMR, such as the settlement functions, the competitive allocations processes under the CFD and the operation of an auction process under the capacity mechanism.

4. Discretion – conflicts and synergies

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.

Given that the full scale and scope of the EMR functions under National Grid's licence are yet to be defined it is difficult to determine whether all the potential conflicts of interest with regard to the ability to exercise discretion have been identified.

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

We believe that there should be limited scope for the EMR delivery Body to exercise discretion under the proposed EMR arrangements. Our preference is for all such arrangements to be subject to defined procedures and processes that are set out under an industry code or codes with sufficiently robust industry governance arrangements.

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.

Given that the System Operator has been given the EMR functions it is the conflicts of interest between this role and EMR that are the key areas of concern. In addition there may be conflicts of interest that may arise **between** EMR functions and these should be considered more carefully.

5. All conflicts and synergies

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

We do not know at this stage whether the potential conflicts between the EMR role and the SO are relatively immaterial. We believe that a substantial testing and trialling of the EMR functions is required to understand the potential scope and scale of any conflicts of interest.

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?

We do not have sufficient information of the way that the EMR functions will operate in practice to determine whether that is any potential conflicts with other activities including the TO and competitive businesses. We suspect that the opportunity may arise for such conflicts and our preference is ring fencing the EMR functions from other National Grid activities to ensure that such conflicts do not arise.

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

We believe that the materiality of any potential conflicts can only be determined by testing and extensive trialling of the EMR business processes and procedures. As noted above, our preference is to ensure that the arrangements are documented in industry codes to ensure that such conflicts cannot occur.

6. Information mitigations

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

No. Conflicts of interest relating to access to information should be addressed through careful design of EMR and EMR governance measures. We do not believe that the proposals in the consultation document go far enough. The EMR arrangements should be established within a ring fenced activities under National Grid's licence and be subject to detailed industry codes that set out the processes and procedures.

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.

The EMR arrangements should be established within a ring fenced activity under National Grid's licence and be subject to detailed industry codes that set out the processes and procedures.

7. Influence mitigations

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.

No – Conflicts of interest relating to influence should be addressed through careful design of EMR and EMR governance measures. We do not believe that the proposals in the consultation document go far enough. The EMR arrangements should be established within a ring fenced activities under National Grid's licence and be subject to detailed industry codes that set out the processes and procedures.

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.

The EMR arrangements should be established within a ring fenced activities under National Grid's licence and be subject to detailed industry codes that set out the processes and procedures.

8. Discretion mitigations

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.

No – Conflicts of interest relating to discretion should be addressed through careful design of EMR and EMR governance measures. We do not believe that the proposals in the consultation document go far enough. The EMR arrangements should be established within a ring fenced activities under National Grid's licence and be subject to detailed industry codes that set out the processes and procedures.

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.

The EMR arrangements should be established within a ring fenced activities under National Grid’s licence and be subject to detailed industry codes that set out the processes and procedures.

9. Mitigations – business separation

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.

We do not believe that the proposed governance arrangements and existing regulatory framework is sufficient to mitigate the conflicts identified. We remain concerned that the scale and scope of National Grid’s activities is yet to be fully defined. Consequently we believe that the starting approach should be based on ring fenced EMR activities subject to development of appropriate industry codes

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

The EMR arrangement should be subject to defined processes and procedures under EMR codes with appropriate governance arrangements.

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

Yes – there should be clear business separation between the EMR functions and National Grid’s System Operation activities.

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

Yes – National Grid should be required under its licence to establish a separate EMR function.

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

We believe that a high degree of business separation is required between National Grid’s EMR functions and its other activities. This should be similar to the separation of transmission activities and generation activities as outlined under EU law.

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

We remain sceptical as to the extent of any synergies between the EMR and SO roles. However, certain limited EMR activities could be carried out by the SO such as long term market modelling. The remaining activities should be established in a separate EMR function.