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

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DONG Energy welcomes the above named consultation on an issue that is fundamental to the successful introduction of EMR. There are two areas of concern within this consultation document which are not fully addressed: the treatment, use and sharing of confidential data submitted (specifically during the CFD and CM price discovery processes) and the use of this data arising from the EMR activities. Answers to the questions raised in the consultation document are provided in the annex but we would emphasise the following:

Our ref. 130121_SO_Conflicts

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1. The analysis within the consultation document is too narrowly drawn. The potential impact on investor confidence and competition in the generation market must be taken into account.
2. The starting assumption of DECC and Ofgem appears to be that the SO should be allowed to use any information received in any manner that it sees fit. Instead, commercially confidential information should be treated as such and sharing of data should be by exception, with the agreement of the disclosing party and after a convincing case for sharing has been proven.
3. The EMR functions should be separately licenced and ring-fenced from the existing SO and TO businesses. There should be restrictions on flows of information within the EMR functions and between the EMR functions and any other part of the existing SO and TO businesses.
4. The premise in the consultation and other EMR documents is that NGET will have no discretion in decision making (although in parts it is noted that some discretion will be allowed). This is welcome but at no point in any the consultation or any other documents is it shown how this will be achieved.

Without confidence that the role of the EMR delivery functions are properly scoped and managed, there will be risk that industry cannot mitigate.

Yours sincerely



Danielle Lane
DONG Energy

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.

No, on the contrary, we believe there will be the potential for material conflicts arising from the GBSO having access to EMR related information. The GBSO is already in a privileged position with access to significant amounts of market information and is incentivised to efficiently minimise balancing costs and ensure security of supply. Given that some contracts may be awarded to intermittent generation, there is a possibility that the advice given to Government will have a bias towards minimising the contracts available to this type of generation. Also, that the outcome of any auction run for both CFDs and capacity will contain a bias towards generation of a particular type or at a particular location that will minimise impacts on SO costs. Whilst the financial impact of this may be relatively small when compared to the overall operating profit of National Grid, it does not make it insignificant and it could have a significant impact on the business case of the auction participants.

Further, the 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 should be treated as such. 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. This extra layer of regulatory risk to investors will continue to exist, if there is uncertainty of the SO's incentives and decisions on contracts and auctions.

- 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.

No, there is no evidence that data relating to capital costs of generation assets or the cost of capital and hurdle rates of individual generators will improve the performance of the SO for the benefit of consumers. Indeed, it may actually have the effect of reducing competition in the generation market as it reduces the incentive on generators to innovate.

- 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.

There are existing licence conditions and restrictions on data sharing between the existing SO functions and TO. It is unclear why the EMR related data should be exempt from these provisions and then be shared with the TO.

Data relating to expected capacity, connection date and technology are already available to the TO through the grid connection contracts. There is little or no evidence that access to confidential and commercially sensitive cost data from generators will improve the performance of the TO.

- 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.

No, the full details of how the capacity mechanism may operate are as yet unclear so such a conclusion cannot be drawn at this time. It may be that the requirements placed on participants in the capacity mechanism are such that they have a significant and material impact on the operation of the gas network and operation.

- e) [NB this question is labelled f) in the document and e) is missing] 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 above, we believe the scope of the assessment has been too narrowly drawn. Whilst consideration of the consumer impact is necessary and welcome, the impact on competition in the generation market has been ignored. Competition in the generation market is what leads companies to innovate and drives efficiency, and hence lower cost. Removing the incentive for generators to compete will not drive lower costs for the consumer.

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.

Yes.

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

Strong and effective ring-fencing of the EMR functions within the SO are an absolute requirement both with respect to the monopoly and competitive aspects of the SO.

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

No.

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.

There is no detail of how the EMR functions will be managed for allocation of CFDs after the first come first served period has passed. Clear and transparent criteria for moving to allocation rounds is required. The consultation document indicates that no discretion in allocating CFDs will be granted to NGET during that period but no detail of how this will be achieved is provided. Without this detail, understanding what conflicts may arise cannot be fully assessed.

Further, the EMR data provided as part of the cost assessment process must be treated as confidential and it must be guaranteed that data relating to individual companies will not be used to influence contract award during any allocation process.

- 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 is currently no detail on what assumptions or methodology the SO is using to establish the advice to Government. As such it is difficult to make a complete assessment of conflicts of interest.

At a high level, bias could be introduced as a result of some scenarios within the analysis providing for a potential increase in balancing costs or greater requirement for network reinforcement.

- 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 synergies are limited to IT and HR cost savings. We do not see any evidence in the consultation of significant synergies in any other aspect of work.

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.

As the consultation document notes, the discretion available to the SO will depend on the design of the CFD allocation process and CM. Without the detailed design of these two policy instruments, it is not possible to say that all the potential conflicts and synergies have been identified.

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

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There is no information on how the SO will choose between a project after the first come first served has been exhausted. For example, if there is limit on the contracts awarded will the selection of two 250MW projects be preferred to a single 500MW project? Or if a 500MW project takes the allocation above the rationing level, will this be rejected in favour of not filling the allocation volume if it has a more positive impact on the SO incentives than a number of smaller projects?

- 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.

No, as noted above we believe the synergies of the SO having this role are limited. The implication that it could use the EMR role to improve its performance suggests a level of discretion in its actions that are refuted elsewhere in the document.

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?

No. The assessment does not account for any impact this approach may have on competition in the generation market. Nor does it account for the detrimental impact it may have on innovation in the generation sector which is fundamental for driving cost reduction in new generation technologies.

- 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.

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

As noted above, consideration of the impact on the generation market should be considered.

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.

Yes, if the EMR functions within the SO are properly ring-fenced from the rest of the SO business. Additionally, within the EMR functions, there must be ring-

fencing of those activities related to data collection from generators and absolute confidentiality with respect to any data submitted.

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- 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.

As noted above, data handling must be absolutely robust and separate from the rest of the EMR functions. Ideally, all EMR functions should be separate from the SO business and should be a separately licensed function. This will give the necessary confidence to generators that they can continue to provide highly commercially sensitive information to the SO without risk that it will become available to a wider audience. Also, that the data it provides for a given purpose will only be used for that purpose.

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.

There must be clear and transparent roles and responsibilities for all aspects of the EMR design and governance. There must also be clear and unambiguous reasoning for why decisions have been taken. These are not currently in place and so it is difficult to judge whether or not they are adequate to address the conflicts of interest relating to influence.

- a) 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.

Transparency of process and clear delineation of roles and responsibilities are key. The publication of clear assumptions and methodologies for how different assessments have been made is also necessary. However, the commercial confidentiality of generators' submissions must be preserved. If this data is provided to the SO it should go no further in its raw form than the individuals responsible for it.

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.

To some degree they can be but there is confusion throughout the document in what discretion, if any, the SO will be allowed. In some places it says that no discretion is possible, in others that there will be decisions made by the SO that will allow for some discretion. This does not give confidence that there is a

clear delineation of role and responsibilities between the various bodies involved in this process.

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- 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.

All of the additional measures are necessary.

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.

The answer is a qualified yes given that we can only make this assessment against a background of a high level understanding of the EMR design and governance arrangements. Whilst the consultation document seeks to assure the industry that the necessary documents will be in place, the fact that they are not available means a full assessment cannot be made.

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

The best approach would be to have the EMR functions delivered by an independent entity.

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

Yes.

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

The EMR functions should be separately licenced and ring-fenced from the existing SO and TO businesses. There should be restrictions on flows of information within the EMR functions and absolutely between the EMR functions and any other part of the existing SO and TO businesses.

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

As noted above, the EMR functions should be separately licensed and ring-fenced from the existing SO and TO functions.

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

Given that the extent of the synergies appear to be related to HR and IT costs, these can continue to be managed to best deliver cost savings. For those aspects of data that may be proven to benefit the SO, there could be limited approval given for data flow from the EMR functions to the SO.