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

Introduction

RenewableUK and Scottish Renewables collectively represent the major sectors and technologies within the UK's renewable energy industry. RenewableUK is the leading UK renewable energy trade body, representing more than 635 members in the wind, wave and tidal stream sectors, and Scottish Renewables represents the renewable energy industry across Scotland, with over 330 members in the wind, marine, biomass and solar sectors. These industries will provide the majority of the renewable electricity required to meet the UK's 2020 emissions reductions targets, create thousands of jobs across the supply chain, revitalise the economy and stabilise consumer energy bills. RenewableUK and Scottish Renewables appreciate the opportunity to contribute to this consultation identifying potential synergies and conflicts of interest arising from National Grid serving as Electricity Market Reform (EMR) delivery agent and hope that the following response is helpful to the on-going work in this area.

RenewableUK and Scottish Renewables are committed to ensuring EMR works. In the following response you will find comments and suggestions to help ensure the system is seen as an attractive environment to investors, particularly given this is the key objective of EMR. It would be counterproductive to implement an otherwise sound electricity market with faults that could be relatively easily addressed through strong ring-fencing of the Great Britain System Operator (GBSO, a wholly owned subsidiary of National Grid) and added transparency to the process of EMR delivery. In short, it is important to minimise conflicts of interest in addition to the appearance of conflicts of interest to attract the necessary investment in the UK's energy infrastructure.

Major Issues

1. Appointing the GBSO as the Government's agent to deliver EMR creates a fundamental conflict of interest. RenewableUK and Scottish Renewables are not alone in our concern. During pre-legislative scrutiny of the draft Energy Bill, the Energy and Climate Change Select Committee expressed concerns regarding the appropriateness of a private company acting as the EMR delivery function.
2. Giving the role of EMR delivery to National Grid, a major player in the UK electricity and gas markets, places it in a privileged position in delivering a system which will pay up to £7.6bn (in 2012 prices) in 2020 to the electricity industry and hence be a key determinant of major investment decisions by other market participants. The profitability of certain National Grid businesses are directly and materially impacted by electricity prices in the UK (interconnector businesses) and investment in generation capacity (gas storage and transmission, and electricity transmission businesses). For example, National Grid has recently signed a Memorandum of Understanding with Mainstream Energy for a pre-feasibility study for the development, financing, construction and operation of a 5,000MW electricity transmission system which will export large-scale wind power from Ireland to the UK from 2017. This project would represent significant value to National Grid

shareholders.

3. The GBSO will be responsible for allocating CfDs and whilst National Grid has said it has no interest in picking 'winners' without clear guidance/criteria from Government the potential for conflicts of interest remains. The only way of fully eliminating this potential conflict of interest is to implement strong ring-fencing of National Grid's functions. In addition to ring-fencing, audit functions and rules for corporate governance should be setup to provide a further layer of protection.
4. National Grid has said itself it does not want to use discretion when awarding CfDs. The process and criteria should be 100% clear to everyone involved as DECC has stated it expects that at some point the budget will become constrained. However, to date DECC and Government have not published the criteria which will be used if the funding ceiling under the Levy Control Framework is approached. It is possible that the chosen criteria may imply real or perceived conflicts of interest that cannot be adequately explored in this consultation.
5. In addition to allocation there are a number of tasks the EMR function will be carrying out including:
 - a. Data collection and analysis to recommend strike prices (and possibly volumes at those prices)
 - b. Data collection and analysis to establish the capacity required for the Capacity Market
 - c. Running the Capacity Market auctions and then managing the Capacity Market
6. These functions raise concerns as to how data collected from individual developers will be used. The current presumption that all information should be used without restriction is concerning. It would be preferable to start with the assumption that all generator information is confidential and the case for it to be shared would need to be proven.

Potential Conflicts of Interest

7. National Grid benefits from incentive mechanisms with regard to its electricity and gas Transmission Owner (TO) and System Operator (SO) businesses and gas Distribution Network Operator (DNO). There is a risk that delivery body decisions will be influenced to unduly benefit National Grid Electricity Transmission (NGET) and other National Grid companies.
8. As a TO, NGET is in competition with Scottish Hydro Electric Transmission Limited (SHETL), Scottish Power Transmission Limited (SPTL) and offshore TOs. There is therefore a significant risk that NGET will look to influence outcomes to favour generation that is either connected, or wanting to connect, to NGET transmission assets.
9. There is also a risk that NGET will favour transmission rather than generation investment for marginal decisions; or try to skew parameters to bias transmission investment, particularly investment in mainland England & Wales.
10. National Grid has a number of commercial arms. There is a risk that National Grid could unduly influence parameters feeding into any auction process (either Capacity or CfD FiT), thus distorting the outcome to the advantage of NGET or affiliated businesses. For example, there is a risk that certain technologies (e.g. gas turbines

or Carbon Capture Storage (CCS)) could be promoted and prioritised above others to the benefit of NGET affiliates (e.g. NG Gas or NG Carbon Capture).

11. The SO will have even greater information access than currently – there is a risk that such information will be utilised inappropriately and influence other SO procurement decisions, e.g., annual STOR procurement. This could unfairly disadvantage other STOR providers.

RenewableUK and Scottish Renewables Position

12. 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.
13. However, in our view these steps do not go far enough to provide the confidence to attract the billions of pounds of investment in generation and transmission required in the UK. To provide the degree of confidence investors require, the EMR delivery function would need to be effectively ring-fenced by:
 - a. isolating the EMR delivery function from all other parts of National Grid to separate it from all potential conflicts
 - b. the ring fence should be strong comprising:
 - i. restriction on information flows from the EMR delivery function
 - ii. physical separation of hardware, facilities and premises
 - iii. separation of employees and remuneration
 - c. establishing the EMR delivery function as a separate legal entity whose directors would act independently of other National Grid businesses and would be responsible for maintaining compliance with independent governance and decision making
14. The GBSO as the EMR delivery function should have normal legal responsibility for the exercise of discretion in implementing the CfD, particularly where the delivery function has not taken due care or its decisions have been inappropriately influenced by National Grid's commercial interests.
15. In addition to ring-fencing a robust auditing function must be in place including the ability to audit corporate governance decisions:
 - a. a regular independent audit function is needed to investigate any potential conflicts of interest
 - b. managers overseeing other National Grid departments/functions must not have influence or insight over EMR delivery functions

Selected Consultation Questions

From the DECC consultation document, we respond to the key question 9 on mitigations – business separation.

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. Given the scope of the conflicts and the magnitude of the money at stake (payments under EMR will be up to £7.6bn (in 2012 prices) in 2020), the arrangements suggested by DECC are not adequate. The involvement of National Grid in the potential construction and

operation of a transmission link to Irish wind farms supplying the UK is a clear example of a conflict of interest.

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

Yes. To provide the high degree of confidence investors require the EMR delivery function would need to be isolated by an effective and high ring-fence. See paragraph 13 above.

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

Yes, the EMR delivery function would need to be isolated by an effective and high ring-fence. In addition, there needs to be clear regulation of corporate governance. Government has said National Grid companies with different roles will have separate directors. However, in most cases strategic decisions are made by the Chief Executive. It is necessary to have strict rules in place in addition to an audit function to look into any potential conflicts of interest as they arise. See paragraph 15 above.

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

The EMR delivery function should be isolated by an effective and high ring-fence.

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

Legal separation of the EMR delivery function coupled with:

- restriction on information flows from the delivery function
- physical separation of hardware, facilities and premises
- separation of employees and remuneration
- the directors of the EMR delivery body would act independently of other National Grid businesses and would be responsible for maintaining compliance with independent governance and decision making

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

Synergies could be protected by regular, transparent publication of non-confidential information which would support the realisation of these synergies between the EMR and SO roles.

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