

**URN 12D/444: Synergies and Conflicts of Interest arising from the Great Britain System Operator delivering Electricity Market Reform – consultation response**

Centrica welcomes the opportunity to respond to the joint DECC/Ofgem consultation on Synergies and Conflicts of Interest arising from the Great Britain System Operator delivering Electricity Market Reform.

Centrica is an integrated energy company operating predominantly in the UK and North America. We are active in each stage of the energy lifecycle from sourcing to generating, to processing and storing, from trading and supplying to servicing and saving energy. We have practical experience of managing a ring fenced subsidiary business. In November 2002, we acquired Rough Storage facility which stores gas under the North Sea on behalf of a number of companies including other Centrica businesses. The business is managed by Centrica Storage, a wholly owned subsidiary of Centrica, and managed at arm's length from Centrica Energy and Centrica's downstream energy businesses with separate premises, information systems and staff.

We welcome the role that National Grid will be playing in delivering Electricity Market Reform. We think it is important and valuable that the Delivery Body is staffed by people who have knowledge of energy markets. Making the Delivery Body part of an organisation which has a long history of experience in energy markets, and also one which performs other relevant roles in the electricity system, is an effective way of ensuring that it can perform its role effectively from the outset. It may be hard to replicate this experience in a specially created agency. This is particularly important given that the role of the Delivery Body in producing the first EMR Delivery Plan is already well underway.

We do, however, agree with the assertions made in your consultation document that there are potential conflicts of interest between the role of the Delivery Body and those of other parts of National Grid. We believe these conflicts could occur in all the areas that the consultation document identifies, namely:

- The ability to access information
- The ability to exert influence
- The ability to exercise discretion

We believe it is therefore appropriate that appropriate mitigation measures are put in place.

There is a particular issue around the EMR Delivery Body's "ability to exercise discretion". We recognise National Grid's desire to avoid having a discretionary role, but at the moment the rules under which the Delivery Body will operate are not defined in detail. Examples, such as how CfDs will be allocated in a budget constrained world and how a capacity auction will be run, are areas where we find it hard to see how rules will be developed which completely remove the Delivery Body's discretion and yet still allow the process to function effectively. In the absence of detailed design rules, we feel it necessary to be cautious in our response to this consultation, and therefore until such time as the Delivery Body's role is defined at a more detailed level, we recommend a strong form of separation to provide the necessary assurance to stakeholders.

Our experience with operating Centrica Storage Limited as a separate business from other parts of the Centrica group demonstrates that full legal, financial and physical separation can effectively meet concerns about conflicts of interest. We believe all these steps are necessary to provide effective mitigation of the conflicts identified by this consultation document. We would therefore recommend that the EMR delivery function is legally, financially and physically separated from other parts of National Grid (option 2b in your document). This will keep the institutional arrangements of EMR robust and sustainable. Even with legal separation it is possible for certain group functions to support the ring fenced entity, so elements of efficiency will still be captured. We believe that less stringent separation will leave the arrangements open to mistrust and criticism.

We recognise that there are also potentially valuable synergies between the EMR Delivery Body and the System Operator role. Once the implementation details of EMR become clearer these synergies will be able to be specified and evaluated with more definition. At the moment, the lack of clarity around the design (of, for example, the Capacity Mechanism or constrained CfD allocation) prevents a proper assessment of the value of such synergies. We believe that it would be better to separate the EMR and SO functions now, and if it can later be demonstrated that value would come from relaxing certain constraints, then this could be consulted upon later.

Our direct answers to the questions posed in the consultation document are set out below.

#### **Information – conflicts and synergies (monopoly conditions)**

**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.**

We believe that it is too early to tell whether there will be material conflicts arising from the SO having access to EMR related information. This is a particular concern with the Capacity Mechanism, where the design has yet to be finalised and consequently the associated processes for delivery remain undefined. There may also, however, be issues with information relating to the CfD allocation processes, particularly where it relates to projects which have interactions with the Capacity Mechanism.

**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 agree that there may be potential for synergies, but again would need to see the full detail of the role and discretion that the Delivery Body will have in delivering EMR before we can properly value these synergies, and thus decide whether they are significant or not.

**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.**

This consultation document identifies one example of a potential conflict (for example, see para 78 on page 29 of the consultation document, which identifies possible problems with the TO being able to anticipate where new generation would need connections). We think there could be others, since the location of new generation and its connection requirements will be of key interest to the TO. We therefore think it is too early to say whether the potential for conflicts or synergies will be limited – a lot will depend on the amount of influence and discretion that will come with the EMR Delivery role.

There is a particular issue around the EMR Delivery Body's "ability to exercise discretion". We recognise National Grid's desire to avoid having a discretionary role, but at the moment the rules under which the Delivery Body will operate are not defined in detail. Examples such as how CfDs will be allocated in a budget constrained world and how a capacity auction will be run are areas where we find it hard to see how rules will be developed which completely remove the Delivery Body's discretion and yet still allow the process to function effectively. In the absence of detailed design rules, we feel it necessary to be cautious in our response to this consultation, and therefore until such time as the Delivery Body's role is defined at a more detailed level, we recommend a strong form of separation to provide the necessary assurance to stakeholders.

**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.**

Please see answer to 1c). The Capacity Mechanism is likely to play a key part in determining the future of CCGTs in the generation mix, and their gas connections will be of relevance to National Grid's activities in gas distribution, gas transmission and gas system operation. Without the final design details and information on the role of the Delivery Body, it is not possible to say whether the potential conflicts will be limited or significant.

**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 above, we believe it is too early to say.

**Information – conflicts and synergies (competitive conditions)**

**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.**

We agree that a number of material conflicts of interest have been identified. A further area of concern might arise for National Grid's interconnection business if it is awarding CfDs to generators outside the UK, that will require interconnection facilities to qualify.

We also note that although some conflicts might be time limited until details are published, it does not diminish the potential value of the information in such a pre-publication period.

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

We agree that additional mitigation will be needed.

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

Please see answer to 2a).

**Influence – conflicts and synergies**

**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 that the advisory role that the EMR Delivery Body will be performing will almost certainly give it the ability to influence. We also agree that some major potential conflicts have been identified by this consultation document – in particular the potential to influence the need for increased network build.

**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.**

We agree with the observation in the consultation document that there might be a benefit to the SO from the over-procurement of capacity, which would make it easier to balance the transmission system, and thus a potential conflict of interest could arise. There might also be issues over the nature of the future technology mix, or the location of particular generation projects that would make them more attractive from an SO point of view.

**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 agree that the main potential for synergies is likely to be between the SO and EMR role, although there may also be a potential for synergies in the longer term planning of the network undertaken by the TO. Without detailed rules as to how the EMR Delivery Body will perform its function, it is difficult to put a value on these synergies.

**Discretion – conflicts and synergies**

**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.**

We recognise National Grid's desire to avoid having a discretionary role, but at the moment the rules under which the Delivery Body will operate are not defined in detail. Examples such as how CfDs will be allocated in a budget constrained world and how a capacity auction will be run are areas where we find it hard to see how rules will be developed which completely remove the Delivery Body's discretion and yet still allow the process to function effectively. In the absence of detailed design rules, we feel it necessary to be cautious in our response to this consultation, and therefore until such time as the Delivery Body's role is defined at a more detailed level, we recommend a strong form of separation to provide the necessary assurance to stakeholders.

We agree that some significant conflicts and synergies have been identified in the consultation document, but will not be able to be satisfied that this list is exhaustive until the detailed processes for the EMR Delivery Body have been decided.

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

Please see answer to 4a).

**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.**

On the basis of the currently available information we agree that the main potential for synergies is between the SO and the EMR role, but without further design details it is difficult to value these synergies.

**All conflicts and synergies**

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

No, as detailed in our answers to the previous questions. We believe that the consultation document has identified a number of valid concerns about potential conflicts, and in the absence of more detailed rules about how the EMR Delivery Body will perform its role, it is not yet possible to assess their materiality, or conclude that they are immaterial.

**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, we believe these conflicts could be material, but cannot assess this in the absence of more detailed rules about how the EMR Delivery Body will perform its role.

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

Firstly, the more detailed rules about how the EMR Delivery Body will perform its role need to be defined and published. Without this first step it is not possible to specify the further analysis that would be needed to determine the materiality of the conflicts.

**Information mitigations**

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

We agree with the assertions made in this consultation document that there are potential conflicts of interest between the role of the Delivery Body and those of other parts of National Grid. We believe these conflicts could occur in all the areas that the consultation document identifies, namely:

- The ability to access information
- The ability to exert influence
- The ability to exercise discretion

We believe it is therefore appropriate that appropriate mitigation measures are put in place.

**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.**

Our experience with operating Centrica Storage Limited as a separate business from other parts of the Centrica group demonstrates that full legal, financial and physical separation can effectively meet concerns about conflicts of interest. We believe all these steps are necessary to provide effective mitigation of the conflicts identified by this consultation document. We would therefore recommend that the EMR delivery function is legally, financially and physically separated from other parts of National Grid (option 2b in your document). This will keep the institutional arrangements of EMR robust and sustainable. Even with legal separation it is possible for certain group functions to support the ring fenced entity, so elements of efficiency will still be captured. We believe that less stringent separation will leave the arrangements open to mistrust and criticism.

We recognise that there are also potentially valuable synergies between the EMR Delivery Body and the System Operator role. Once the implementation details of EMR become clearer these synergies will be able to be specified and evaluated with more definition. At the moment the lack of clarity

around the design (of, for example, the Capacity Mechanism or constrained CfD allocation) prevents a proper assessment of the value of such synergies. We believe that it would be better to separate the EMR and SO functions now, and if it can later be demonstrated that value would come from relaxing certain constraints, then this could be consulted upon later.

### **Influence mitigations**

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

No – please see answer to 6a).

**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.**

Please see answer to 6b). We would recommend that the EMR delivery function is legally, financially and physically separated from other parts of National Grid (option 2b in your document).

### **Discretion mitigations**

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

No – please see answer to 6a).

**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.**

Please see answer to 6b). We would recommend that the EMR delivery function is legally, financially and physically separated from other parts of National Grid (option 2b in your document).

### **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.

We agree with the assertions made in this consultation document that there are potential conflicts of interest between the role of the Delivery Body and those of other parts of National Grid. We believe these conflicts could occur in all the areas that the consultation document identifies, namely:

- The ability to access information
- The ability to exert influence
- The ability to exercise discretion

We believe it is therefore appropriate that appropriate mitigation measures are put in place.

Our experience with operating Centrica Storage Limited as a separate business from other parts of the Centrica group demonstrates that full legal, financial and physical separation can effectively meet concerns about conflicts of interest. We believe all these steps are necessary to provide effective mitigation of the conflicts identified by this consultation document. We would therefore recommend that the EMR delivery function is legally, financially and physically separated from other parts of National Grid (option 2b in your document). This will keep the institutional arrangements of EMR robust and sustainable. Even with legal separation it is possible for certain group functions to

support the ring fenced entity, so elements of efficiency will still be captured. We believe that less stringent separation will leave the arrangements open to mistrust and criticism.

We recognise that there are also potentially valuable synergies between the EMR Delivery Body and the System Operator role. Once the implementation details of EMR become clearer these synergies will be able to be specified and evaluated with more definition. At the moment the lack of clarity around the design (of, for example, the Capacity Mechanism or constrained CfD allocation) prevents a proper assessment of the value of such synergies. We believe that it would be better to separate the EMR and SO functions now, and if it can later be demonstrated that value would come from relaxing certain constraints, then this could be consulted upon later.

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

Please see answer to 9a).

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

Yes. Please see answer to 9a) for further details.

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

The EMR Delivery Body – please see answer to 9a) for further details.

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

We would recommend that the EMR delivery function is legally, financially and physically separated from other parts of National Grid (option 2b in your document). Please see answer to 9a) for further details.

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

We recognise that there are also potentially valuable synergies between the EMR Delivery Body and the System Operator role. Once the implementation details of EMR become clearer these synergies will be able to be specified and evaluated with more definition. At the moment the lack of clarity around the design (of, for example, the Capacity Mechanism or constrained CfD allocation) prevents a proper assessment of the value of such synergies. We believe that it would be better to separate the EMR and SO functions now, and if it can later be demonstrated that value would come from relaxing certain constraints, then this could be consulted upon later.