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Dear Jonathan

EMR: Consultation on Synergies and Conflicts of Interest Arising From the Great Britain System Operator Delivering Electricity Market Reform

Introduction

Eggborough Power Limited (EPL) is an independent generator which owns and operates Eggborough Power Station (EPS), a 2,000 MW coal fired power station situated in the Aire Valley in North Yorkshire. EPS was previously owned and operated by British Energy (and latterly EDF) to provide flexible and reliable mid merit support to the “baseload” nuclear portfolio. EPL is now owned by two substantial private shareholders and is operating as an essentially merchant power plant in the wholesale market.

Electricity Market Reform (EMR) Policy and the role of National Grid (NG)

While EPL welcomes this consultation, the lack of real detailed design makes it very difficult to comment on the document. Without the detail over how exactly National Grid (NG) will perform its functions, EPL feels that separation of its functions will be required to ensure there is no influence exerted over the EMR delivery team by the transmission owner (TO) and system operator (SO) roles.

Parties have considerable concerns about providing data to NG that they may then use for other processes, or putting NG in a position where they can unduly influence market developments. EPL believe there is a material risk that NG will allocate contracts to specific plant types, in specific locations in order to meet their SO or TO interests. We therefore feel that full legal separation should be the default position unless NG can demonstrate that there is a quantifiable money saving synergy, without potential risks arising, from merging some activities together. Through this response we have therefore referred to NG, rather than the SO, as EPL believe the new EMR delivery function should create a separately defined and licensed activity under NG's broader ownership.

While the document highlights Centrica's undertakings on separation that were agreed as a requirement of the acquisition of Rough, EPL believes that there are some slightly different regulatory frameworks for separation that DECC can also consider as a template: Distribution Network Operators (DNOs) from their parent companies; and a structure along the lines of the Monopolies and Mergers Commission's decision on British Gas separation. While the regimes have all been slightly different, they have all offered an effective way of ensuring the relevant companies have different business arms that are solely focussed on delivering their own business goals, efficiently and without undue influence from other business interests.

EPL would propose that the delivery function be defined in NG's Electricity Transmission Licence, with responsibilities set out separate to its SO and TO roles, with defined interactions between the business functions. The actual mechanics of delivery should be approved by DECC and Ofgem, following consultation with the industry. These 'rules' can then be subject to a change process, similar to the Balancing Principles or SQSS. The more commercial aspects of the new regime, such as how parties pay or are paid should be open to more flexible, industry code type, governance. This should strike a good balance between stability and adaptability, under pinned by transparency and consultation.

NG's Businesses and the proposed Government approach

EPL is concerned that the Government's approach to assessing the strength of the required mitigation actions will not do enough to prevent the SO from being incentivised to act in its own interests. The SO has incentives surrounding how it balances the system and the way it invests in transmission assets and it therefore, not unreasonably, wants certain types of plants to be located in specific areas of the system to make balancing easier and cheaper, or justify TO spend. If the rules for the allocation of CfD FITs and the capacity mechanism (CM) plant are entirely mechanistic then NG should have very limited ability to influence the process of plant choice. However, without the exact detail of processes, EPL would urge DECC to require full separation of NG's EMR delivery team from the TO and SO functions at least to begin with.

DECC suggests that *"where the impact on profitability from acting on a conflict is low, the incentive for National Grid to act on the conflict is low"*. Whilst this may be true now, the evidence given to support this view represents a snapshot-in-time and shows where NG's profits lie currently. If, or when, this balance of profits changes in the future, NG's potential areas for conflict will change with them. It would be foolhardy to expect NG to reject the opportunity to legitimately maximise its profitability and operational efficiency in any area. However, by virtue of the way they act NG may, however unintentionally, create inefficiencies elsewhere in the market. EPL would like the Government to uphold the principles contained in the Government's confidentiality agreement with the SO and ensure total separation of the EMR delivery body from NG's other business interests.

The Delivery Role for the SO

EPL support the Government's proposed mitigation methods (information restrictions, ring-fencing, and transparency and scrutiny, limiting discretion and

business separation), but remain concerned that the document implies that these actions would be taken independently of each other i.e. one or the other. EPL would prefer that the Government established an EMR delivery body, which would then be bound by all of the mitigation methods in the consultation. Establishing a legally separate entity to deliver EMR will be simpler to manage than assigning certain restrictions onto one set of activities but not others within different areas of the SO's business. EPL supports the Government's proposal to enforce the SO's responsibilities as the delivery body through relevant requirements in its licence creating a strong incentive on the SO to comply. Our enthusiasm for this approach is tempered slightly by the fact that it can often take Ofgem a long time to determine whether there has been a breach of a licence, and then remedy the situation. If there was suspicion that a licence breach had occurred Ofgem would need to take corrective action quickly so as not to undermine EMR processes, such as the awarding of the CfD FITs.

Full legal separation has the additional benefit that if a problem with NG arose in the future, to the extent that the Government felt it must use its powers under the Energy Bill to move the delivery role to another body, this could be achieved more easily. To separate out integrated teams and systems could make any required transfer a very slow and costly process.

EPL recognise that there is a lot of information used in NG's assessment roles that would need to be duplicated under full separation. For example, the need for the CM, and then the volume of capacity to meet the identified requirement, fit well with the work NG does on the TYS. Likewise the outcome of the CM will feed back to TO planning. However, it would be possible to create, with industry's help, a series of procedures for acceptable data flows between the EMR team and the SO/TO functions. This could leave the current NG teams leading on assessment of broad need, forecast renewables output, etc. and the EMR team running the mechanistic allocation of FITs and CM contracts, etc.

Capacity Market (CM)

EPL is concerned about the SO's ability to 'profit' from its position as the expert advisor to the Government. The Government has highlighted that NG can 'profit' by influencing decisions in favour of NG's businesses, being privy to commercially important information ahead of the market, and exercising discretion in its decision-making. EPL feel that the Government must prevent the SO from acting in this fashion by developing rules, thresholds, processes, and framework in an open, fair and transparent consultation process with industry. We also urge the Government to establish transparent monitoring and auditing processes of the SO's decisions to give confidence to the market that no undue discrimination is occurring.

As the owners of a coal plant, EPL is particularly concerned that NG is likely to favour CCGT assets for the CM as offering greater flexibility to the SO in balancing. This could prejudice its pre-qualification decisions and also lead it to push for new plant over old in the CM. Participation in the CM should be open to all fuel types, smaller generators as well as the larger CCGTs, as any plant that has reliable output can make an equitable contribution to system security. The CM is not the way to

deliver balancing, it is a way to ensure delivery at peak, which in our view all reliable generation can do.

NG should have very limited, if any, discretion in its decision-making given the proposed tender structure. If the SO is setting the location, volume and technology type for the plant secured under the CM, then it may favour an outcome that places CM plant where its electricity or gas networks have excess capacity. EPL therefore feels that the pre-qualification stage of the CM needs significant development before risks can be judged. EPL supports the proposal for the final decision to rest with the Government or Ofgem. Locational signals for NG the TO and NG as a gas company, along with other TOs, should be sent via the charging regimes for TOs, not via EMR. An appeals mechanism for industry parties should also be established, for when there is enough evidence to put case against an SO's decision.

EPL supports the use of an independent Panel of Technical Experts (the Panel) to sense check NG's forecasting and assessments. However, the Panel must include experts with industry know how, i.e. have built and operated plants, rather than pure academics. We also fully support scrutiny through public consultation of the SO's analysis and subsequent key decisions. EPL feel that the proposed level of scrutiny may vary with experience, and between years, with different levels of investment decisions. The Government may therefore want rules that allow scrutiny of the SO's advice 'from time to time', rather than hard wiring a review timetable. EPL would also favour a robust mechanism to allow industry parties to appeal against the SO's analysis or decisions. This would provide a safeguard against potential problems later on.

While the Government's work on CfD FITs seems to have developed some design detail over the assessment of projects for "qualification", this does not appear to be the case in the CM. EPL believes very little qualification should be required from existing plant as the BMRS, metered data, etc. will already be known. If a plant offers more capacity than NG believes can be delivered that may be as a result of investment going in over the period before delivery. The proposed trading of rights, testing and penalty regime should all ensure the offered capacity is probably a conservative volume. For new plant, realistically they will not want to spend too much prior to tendering so expecting signed EPCs, financing, etc. would create a barrier to participation.

EPL is unclear how the assessment will cover the feedback loop in company decision making that the CM will create; a plant does not get a CM contract so it then decides to close, so the CM requirement goes up. Any assumptions made in the assessment process will therefore need to be transparent in a way that NG's current forecasting is not. Where this obligation sits within NG's roles needs consideration.

Contracts for Difference (CfD)

EPL welcome the change in policy so that the NG will not have responsibility for managing contractual relationships with CfD parties. The SO's role as the provider of expert analysis is more appropriate. The revised proposals offers a structure that is bankable and will give reassurance to investors without creating additional issues for suppliers or NG's credit rating (which is vital to their monopoly asset businesses).

As with the CM, Government must ensure that the NG's CfD assessment process is as mechanistic as possible, with it being unable to reject projects for unspecified or ill defined reasons. EPL endorses the Government's 'first-come, first-serve' approach to the bulk of the CfD allocations (subject to meeting the eligibility criteria). EPL remains opposed to the limited pot for biomass and continues to believe it would be more efficient to have one pot that all plant is qualifying under. Allowing developers to choose technology and when they submit an application for a CfD will give maximum flexibility and avoid the additional costs and inefficiencies of sticking to a rigid allocation system. However, there are a number of eligibility criteria that require careful consideration, for example the costs of navigating the planning system, and securing a connection, are significant and investors will only progress if they feel confident they will receive support and are not being unfairly treated by the SO.

An efficient and timely assessment process, with obligations on the SO to meet deadlines, so developers should not experience unexpected delays during this stage of the project, would add to the efficiency of the process. It will provide greater confidence that NG is not delaying eligibility decisions for projects which it deems less favorable e.g. projects which will result in smaller profits (TO could profit from an increase in the development of onshore wind). EPL consider that the SO must have no discretion in this area and be bound by a transparent, reasonable timetable.

EPL support the Government's proposal to protect confidential project information that NG receives as part of EMR delivery. There are potential material conflicts arising as a result of the SO sharing this type of information with some of NG's competitive businesses, including its CCS business and offshore transmission business. CCS is a CfD-eligible technology and therefore a potential investment opportunity for developers. EPL consider that any anti-competitive behavior from the NG would only serve to increase inefficiency and drive up costs for consumers.

Further details are required around the full accreditation process for the renewables plants before they are eligible to get FITs. As noted above the key to market confidence is to limit NG's discretion in reaching decisions on specific projects. Ofgem has taken years to build up the expertise to undertake the ROC accreditation work and it is not obvious that NG currently has the necessary skills set to undertake similar work in an impartial manner. Government may wish to consider if there is scope to transfer some expertise from Ofgem to NG. In the longer term there is a need to manage the administrative inefficiencies that will inevitably come about as a result of running the CfD and Renewables Obligation (RO) in parallel to CfD FITs, which requires further consideration.

National Grid and Incentives

The Government has persisted with ideas surrounding the use of 'cost efficiency' and 'delivery of pre-defined outputs' incentive regimes as a tool for performance measurement of NG's EMR delivery functions. EPL does not support the use of incentives to drive efficiency into the operation of the functions, especially if the implementation and operations are mechanistic in nature. The CM and CfD schemes should be administered schemes, operated on a cost pass through basis under NG's price control. Introducing these pressures creates potential for conflicts

to arise and behaviour become distorted in some areas. The possibility of 'over rewarding' NG while at the same time creating new risks does not appear to be risks worth taking at the current time.

EPL hopes these comments are helpful. If you or your colleagues would like to discuss any of the issues raised please do not hesitate to contact me.

Yours sincerely

Michelle Dixon
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