

ANNEX 1

Response to specific 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.

Response:

In summary, we do not believe that new conflicts arise through receipt of EMR information but, as a matter of good commercial practice and in the interests of maintaining industry confidence, information received only through the EMR process should be available only to the limited number of NGET employees who need it to carry out defined EMR functions (“the EMR Team”). To respond fully to this question it is important first to be clear what EMR related information is. We currently have a generic view of the information that will be received through the EMR role: first there will be a duplication of information that is already received by NGET for other purposes and this must continue to be available as now for the SO and TO to use as appropriate. Second there will be information similar to other information received for existing other purposes but at a greater degree of detail, and some may be entirely new. Unless there is a clear agreed consumer benefit this second category (to the extent that it is additional to that otherwise obtained) should not be shared beyond the EMR Team.

This second category of information may itself fall into more than one category. There will be some (eg specific build costs) which we believe should remain permanently confidential, but there will also be some that it may be helpful to the industry at large and in the interests of transparency to publish. Feedback at Ofgem and DECC’s recent workshop suggests that the industry still believes it does not have sufficient clarity on details to make an informed assessment about the appropriate level of separation rules: until they do, they are naturally conservative regarding the appropriate level of protection required. We hope that clarity on the details and treatment of specific information will provide comfort.

As the integrated TSO, NGET already has access to commercially sensitive energy industry information that it needs in order to operate, develop and maintain an efficient, economic and co-ordinated system of electricity transmission and is accustomed to managing and protecting that information in accordance with regulatory and commercial requirements. This includes, for instance, information provided under the terms of the Grid Code and the CUSC¹ and information collected as part of its development of future network scenarios under existing regulatory obligations. Information that NGET receives as a result of its licensed activities is protected from disclosure to third parties by s105 Utilities Act 2000, under which there are criminal penalties for breach.

Our current view of information that is likely to be received through the EMR role is analysed in more detail in Annex 5.

¹ Connection and Use of System Code

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.

Response:

Yes: these synergies fall into 4 categories:

- Activities which are currently undertaken where the SO can use existing processes and systems for EMR purposes and avoid or reduce implementation effort (eg NGET's existing requirements to develop and publish electricity demand and generation scenarios and forecasting and capacity adequacy analysis);
- Activities which are currently undertaken which are very similar to those that will need to be done for EMR, where they may need to be done differently for EMR (eg for reasons of speed, or volume). In these cases the approach could be adopted by existing activities to improve efficiency or effectiveness of the SO (eg our electricity demand and generation scenarios and forecasting and capacity adequacy analysis);
- Areas where NGET has knowledge or expertise (irrespective of process and system) which is of value to EMR but which could be denied to EMR if there was a high degree of separation (e.g. modelling of the wider energy sector including heat, transport and gas markets).
- Minimising duplication of SO tasks that would be needed to accommodate EMR and avoiding hand-offs between the SO and the EMR delivery body that would be necessary if a third party had that role.

The value of these synergies does not just lie in their applicability to EMR but also in:

- The speed with which the SO's existing knowledge base and experience in the energy market has been made available to EMR. This has meant, for instance, that some design work has already been completed which might have been more challenging had the SO not been fulfilling the Delivery Body role;
- NGET, as incumbent GBSO, is best placed to do network modelling for Great Britain. This is supported by the fact that the System Operator for Northern Ireland (SONI) will have to feed in the relevant similar analysis for Northern Ireland as they are best placed to do so;
- Their maintenance: the skills and knowledge that NGET brings to EMR have been developed over many years through ongoing exposure to the issues and reality of life in the centre of the industry. This includes the consultative nature of our scenario development, the energy sector wide nature of our analysis, covering, heat, transport and power sectors. Separation from this exposure will stunt this ongoing development and, over the long term, the EMR Team would become increasingly detached from the issues being faced by the industry;
- Their largely holistic nature: because of NGET's position in the industry we have knowledge, skills and experience in all areas of expertise required by EMR. If a different organization carried out the delivery body role, it would still require considerable input from NGET and there could be a negative impact arising from less timely access to wider market data.

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.

Response:

We agree that conflicts and synergies arising from the TO having access to EMR information are limited. However, it is important not to lose sight of synergies between the SO and the TO, loss of which would lead overall to less efficient development, maintenance of the transmission system, a less efficient system operation, and a poorer outcome for consumers.

There will be instances where these synergies are bolstered through access to certain EMR information and as noted above, some direct EMR/TO synergies. Whilst we do not believe that TO access to EMR information is likely to lead to conflicts, as set out in our response to question 1(a) above, certain commercially sensitive information will be provided through the EMR function which is not relevant to either transmission or system operation and as a matter of good commercial practice we believe that this should be available only to the EMR Team.

To respond specifically to the potential for conflict between the EMR function and TO activity identified in paragraph 78 (page 29) of the consultation, the TO already has early information on proposed development of new generation as a result of its duty to make connection offers. If there were a genuine risk that NGET would speculatively buy such land it would presumably already be doing so. Doing so would, however, raise issues under competition law as well as under Special Condition C1 of NGET's licence (prohibition against giving or receiving an unfair commercial advantage) and of Condition B6 (restriction on activity and financial ringfencing)². We anticipate that the EMR function will be a transmission business activity under NGET's licence so these Licence Conditions and s105 will apply. We also anticipate an amendment to the Utilities Act which will have the effect of applying s105 to information received through the EMR functions and so prohibit its disclosure outside of NGET.

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.

Response:

Yes, but we also do not believe that as the current regulatory and commercial regimes for gas and electricity stand, gas distribution or transmission will (or should) have access to any EMR information. The transfer of information between NGET and National Grid Gas plc (NGG) is already strictly limited³ and so we see no realistic scope for conflicts to arise.

Given the timescales involved, it is difficult to see how there could be any conflict between Gas System Operation and electricity transmission (e.g. project specific building costs for new power stations has no relevance to the real time operation of the gas network.).

Gas TO investments are driven by shippers purchasing capacity in various entry or exit capacity auctions. As a result, NGG could not invest to deliver capacity ahead of the signal from the shipper (based for instance on Capacity Market information) without taking a significant risk that Ofgem would disallow the expenditure.

² See Annex 2 & 3 for more information about these Licence Conditions

³ See Annex 2

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- e) 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?

Response:

We have not identified any.

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.

Response:

Only NGET (not National Grid plc) will have increased access to information and its licence conditions, section 105 Utilities Act 2000 and Competition Act 1998 all place restrictions on the transfer of that information to other companies within the National Grid group⁴.

Overall the potential conflicts described do not seem to be supported by the evidence, nor do they appear to be material. For instance, interconnectors are funded by shareholders so inefficient investment would fall on them rather than consumers, CCS is dependent on winning a government competition so early access to information is irrelevant, LNG importation projects are customer led and dependent on long term contracts being struck with gas shippers, so advance knowledge of gas demand is irrelevant, and National Grid's gas storage business consists of a single over ground facility that is scheduled to close in 2018. This is examined in more detail in Annex 6.

However, there is no reason why National Grid's unlicensed businesses should have access to EMR information earlier than any other business. Existing controls⁵ would already prevent such access but we nonetheless support specific conditions in NGET's licence which will explicitly segregate and protect such information within NGET (and therefore from other businesses in the National Grid group).

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

Response:

As a matter of good commercial practice and to promote market participant confidence we do agree that there should be licence requirements that prohibit NGET from passing EMR information to other businesses in the National Grid group including those mentioned above. NGET's licence already contains that prohibition and is strictly adhered to. The details of the statutory and regulatory restrictions (current and planned) and the background to them are set out in Annexes 2, 3 and 4;

To the extent that existing controls are not deemed to be sufficient mitigation, we therefore support a modification to NGET's Licence to include a specific condition that would limit access

⁴ See Annex 2

⁵ See Annex 2

to EMR specific information to the EMR Team.

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

Response:

No, but the specific condition suggested in our response to (b) above will protect against the risk that something else is identified later.

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.

Response:

Due to the nature of the regulatory regime, we doubt if potential conflicts identified are likely to materialise in practice: eg over procurement of capacity under the Capacity Mechanism would not benefit NGET. To the extent that the outcome of the capacity auctions impact on NGET's incentivised activities we would expect Ofgem to reflect this in the design of the relevant incentives.

We agree that the SO/EMR synergies listed (promoting a holistic system and efficiency improvements) are the most important with potentially real benefits to consumers in cost savings. In addition, existing expertise in relevant areas eg demand forecasting and, scenario modelling is readily transferable to the EMR function;

In respect of the potential EMR/TO conflicts listed we doubt that these could arise in practice due to the nature of the regulatory regime and the practicalities of system operation. We have set out more detailed comments on the potential conflicts identified in Annex 7.

We note that no TO synergies are listed in the consultation: in the context of the debate about the need or otherwise for SO/TO separation it is important to note the synergies that do exist between the SO and TO. Some of these are set out in Annex 8.

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.

Response:

No realistically material conflicts have been identified that cannot be managed either through existing controls or an enhancement of the existing controls described in Annex 2. To provide greater confidence for the industry we would support:

- amending NGET's licence to protect EMR specific information within NGET,
- scrutiny of the SO's advice to government by the Panel of Technical Experts; and
- transparency of advice so that it can be reviewed by other industry players through the draft delivery plan consultation process.

These will mitigate against any risk that NGET could successfully skew advice in favour of itself or

its affiliates.

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.

Response:

There are strong synergies between the SO and EMR roles and, as set out in response to question 3(a) above, there are also synergies between the TO and SO roles which should not be discounted.

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.

Response:

It is not clear that the potential conflicts identified are realistic risks. In particular:

- The design of technical rules and processes will be subject to consultation and industry participants will be able to input into this process. There will also be enduring change, dispute and appeal mechanisms;
- There will be consultation on rules before they are finalized and they should in any case be clear enough that “interpretation” cannot disadvantage a participant; and
- Onerous requirements on specific participants or applying technical requirements in a discriminatory way would already be discriminatory and in breach of Special Condition C1 as well, possibly of competition law.

Generally, we support the development of a regime which will limit the ability of the SO to exercise discretion and, where there is such an ability, we would expect that the way in which it is used will be very transparent, with a formal dispute resolution and appeals procedure, where appropriate. In the main, we anticipate the majority of NGET’s EMR decision making to be mechanistic, based on transparent criteria and so creating little real risk of conflict. For instance, the allocation of CfDs, pre-qualification and monitoring of CM are described matters where the SO will be working to pre-set rules and will have very little discretion.

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

Response:

As set out in our response to 4(a) above, it is not clear that NGET will have much real discretion. The argument (paragraph 88) that the SO business could benefit from making decisions to favour capacity that creates a more flexible and responsive generation mix is hard to understand and seems to arise from incomplete knowledge of incentive mechanisms. The SO will not be making policy decisions, rather it will be analysing scenarios required by government. In any case, a more flexible and responsive generation mix which assists the economic and efficient balancing of the system will be in the interests of consumers.

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.

Response:

There are strong synergies between the SO and EMR roles. More important, there are also

strong synergies between the SO and TO roles which have been taken into account in National Grid's business plan on which NGET's latest 8 year price control under RIIO is being set. In structuring relevant protections, it is vital that these synergies are not adversely impacted.

We agree that there are no conflicts of interest with the SO that cannot be managed by EMR process design but, similarly, there are no conflicts with the TO that cannot be so managed.

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?

Response:

We agree that there are no potential conflicts between the EMR role and the SO role that cannot be managed by process design and licence amendment to protect EMR specific information. The same is true of the EMR role and the TO role.

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?

Response:

We believe that a careful analysis of each of the potential conflicts identified would demonstrate that the risks are either not present or are very marginal and that the regulatory measures that already exist are adequate to deal with them. It is important that any remedy for a perceived conflict does not impact on the very real synergies between the TO role and the SO role.

In respect of National Grid's non-regulated businesses, we can understand why there is concern, however:

- Any risks that might be perceived to exist would be prohibited under existing NGET licence conditions. National Grid's unregulated businesses are also subject to a group undertaking that National Grid plc, as their ultimate controller, will ensure that they will take no action that could place any of the licensed businesses in breach of their licences or legislation and their activities are also, to a limited extent, "regulated by association" as there are certain activities (for instance electricity generation) that they are prohibited from carrying on. There is no commercial logic in the National Grid group acting in a way that could place its licensed businesses at risk; and
- We do, nonetheless, support licence amendments that strengthen the protection of EMR specific information if deemed necessary and we welcome the role of the Panel of Technical Experts in sense-checking our conclusions. We will support contractual arrangements that protect information of industry players.

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

Response:

We would be happy to contribute to any further analysis that is considered to be necessary.

6. Information mitigations

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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

Response:

We recognise that some aspects of the licence can be read in different ways. The interpretation of NGET's licence set out in Paragraphs 182 and 183 of the consultation does not accord with the interpretation we put on it. In Annexes 2, 3 and 4 to this document we have set out the controls on NGET that currently exist both in legislation and licence, the background to the introduction of Special Condition C1 and the new role of independent directors. The provisions of Special Condition C1 specifically do place broad information separation requirements between NGET and National Grid's affiliated Interconnectors, CCS, and LNG importation and storage businesses. NGET is specifically prohibited from conferring any unfair commercial advantage on any of its affiliates or related undertakings. NGET itself must also conduct its transmission business to ensure that it obtains no unfair commercial advantage. We anticipate that the EMR function will form part of NGET's transmission business, so Special Condition C1 itself will prohibit NGET from using any information received through the EMR process in a discriminatory way that confers any such unfair commercial advantage. This is reinforced by other licence conditions, s105 Utilities Act 2000 and general competition law.

We do agree that conflicts of interest relating to access to information can be addressed very effectively through existing measures and the measures cited and would suggest that the existing obligation for a Compliance Statement and annual reporting through Special Conditions C2 and C3 of NGET's licence should capture EMR Specific Information in due course;

In respect of the measures cited:

- *Ringfencing of EMR specific information*: "ringfencing" is not precisely defined. We do agree that EMR Specific Information should be collected and stored through a system which has controlled access. Access should only be available to the EMR Team;
- *Transparency of non-confidential information and transparency of processes for EMR delivery*: we believe that transparency is key to the successful deployment of EMR and we will work with DECC and the industry to identify information that is non-confidential (or which becomes non-confidential through the passage of time) and to develop a process under which such non-confidential information is publically available at the earliest possible stage. We also anticipate that the systems and methodologies that we use in scenario development will be available to other industry players so that they can verify NGET's assessments; and.
- *Governance framework*: oversight of how EMR Specific Information is used is a valuable control: we believe that Ofgem has a role to play here through enforcement of appropriate and proportionate licence conditions.

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.

Response:

Our view on each of the additional mitigation measures cited in paragraph 185 is:

- *Management of information agreement with DECC*: the existing Memorandum of Understanding should remain in place in some form until appropriate and proportionate licence conditions to protect EMR specific information are in place;;
- *Measures similar to Rough undertakings*: All National Grid companies, whether licensed or

not, are subject to a group undertaking not to put any of the licensed businesses in breach of their licences or relevant legislation: additional undertakings are unnecessary;

- *Restrictions on flow of information to narrowly defined entities:* this could also be narrowly defined activities such as the EMR function. In principle (and subject to our comments on transparency in our response to Question 7(b) below) we support a process under which EMR specific information is available only to the EMR Team, unless there is a clear agreed synergy with the SO or TO function leading to a consumer benefit. This should be managed through appropriate and proportionate licence conditions;

Business separation to reduce incentive to use information: in respect of those described in Annex C to the consultation:

- *Information separation through restrictions on access to confidential information and computer systems:* as set out above, we propose that EMR specific information should be collected through a single point and be accessible only to the EMR Team within NGET;
- *Separation of employees and staff:*
 - The performance of one National Grid business unit is unlikely to impact on existing employee incentive schemes and we can see no benefit in requiring separate schemes. Indeed, such schemes might have the perverse effect of increasing the incentive on an individual employee to favour their own specific area of the business;
 - Restrictions already apply to the transfer of certain staff between certain National Grid businesses and this might be replicated for EMR. There is, however, a business and potentially personal cost in such restrictions and they should not be imposed lightly. In particular, such an approach may disincentivise staff with the relevant skills from working in the EMR function in order to avoid longer term restrictions on their career development;
- *Appointment of a compliance officer:* NGET's licence already requires such an appointment: the compliance officer has specific reporting duties. This role could if necessary be extended to capture the EMR role.
- *Physical Separation;* There are different degrees of physical separation: separation of property, facilities and premises as described in the consultation, is at the more extreme end and would involve significant additional cost which would ultimately fall on consumers. Requiring certain personnel to occupy space within a building that is separate from certain other personnel is less onerous and less costly; and
- The *Financial separation and additional financial obligations* identified in Annex C to the consultation already appear in NGET's licence. In addition NGET can only contract with other National Grid businesses on an arm's length, normal commercial terms basis and in a manner that avoids giving or receiving any cross-subsidy. In the context of the SO/TO the EMR function would be small and a further requirement to manage the EMR function on a financially stand-alone basis from the SO/TO could lead to a disproportionate additional cost in relation to any benefit gained.

Legal separation (as well as the more extreme forms of business separation) will lead to higher overhead costs through maintaining separate premises, creation of duplicate back-office functions (eg HR, legal), separate IT systems, and its own directors. These are costs that would ultimately fall on the consumer.

We are concerned that a greater than necessary degree of separation might be imposed as a

precautionary measure. Realistically, once established, the degree of separation would never be reduced and EMR/SO synergies would be permanently lost. It is, therefore, important that separation measures are proportionate and address a real risk: this is in accordance with Chapter 4 of the draft Energy bill, under which the Secretary of State, in determining the “appropriate” degree of business separation, must have regard to the efficient and effective carrying on of the EMR function, the SO functions currently authorised by NGET’s licence and any other functions authorised by NGET’s licence. Increasing levels of separation later in case of need is feasible.

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.

Response:

Existing checks and balances already protect against the potential conflicts that have been identified. We nonetheless support strengthening NGET’s licence conditions to restrict availability of EMR specific information to the EMR Team within NGET. As well as potentially breaching its licence and competition law, National Grid faces reputational damage if it is seen to be biased in its advice and this would undermine not only its role in respect of EMR but also its role as GBSO generally.

We also support the creation of the role of the Panel of Technical Experts whose scrutiny of NGET’s advice and methodologies will ensure an unbiased position.

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.

Response:

We also support a very transparent EMR process, with openness and transparency of the method by which outcomes are reached giving other industry participants, academics and other interested parties the opportunity to scrutinize advice and methodologies on an informed basis and to check and verify advice and conclusions reached. There is a balance to be reached between transparency and protection of an individual’s commercially sensitive information. However, where practical and acceptable our starting point is that certain EMR information should be made public at the earliest opportunity (the exception being specific commercially sensitive information).

In addition we expect that the Government will seek further scrutiny from other third parties without reference to National Grid.

We have not identified any particular advantage in publication of an impact assessment, but it might be appropriate to do so in specific cases. There will be a cost in preparing such an assessment which will ultimately be borne by consumers

We support the SO using key assumptions provided by Government for its analysis. We would expect that such assumptions would be tested with others including Ofgem and its Panel of Technical Experts (PTE).

National Grid is supportive of incentive schemes where they can be designed to deliver benefits

to consumers. National Grid is already disincentivised from “using” a conflict through the potential imposition of fines of up to 10% of turnover.

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.

Response:

Yes. Under the Institutions design for EMR all policy decisions will be made by Government (or possibly Ofgem); National Grid strongly supports this outcome. For CfDs NGET’s role will be to provide a range of strike prices for CfDs based on assumptions set by Government. The methodology and assumptions used for calculating the strike prices will be available so third parties can verify calculations (transparency), and the PTE will also scrutinize the results.

For the allocation of capacity we anticipate following a transparent and mechanistic process that has been agreed with the industry to achieve a security of supply outcome that is set by government. The analysis that we do to establish what is required to achieve that standard will be scrutinised by the PTE and form part of the delivery plan consultation. .

Transparency in decision-making is key for both the CfD and CM processes and for the delivery body role and we support making as much EMR information public as is practical at as early a stage as possible.

Finally all of NGET’s EMR delivery activities will be subject to regulatory oversight – if it acts in breach of its licence in carrying out the role (eg through discrimination in favour of another National Grid business) as previously noted it could face penalties for breach of licence of up to 10% of NGET’s turnover.

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.

Response:

It is vital that all policy decisions including the level of strike price and how much generation is needed to ensure an adequate level of security of supply remain with government or Ofgem. It may not, however, be efficient to refer every minor decision back through government but there should be a clear decision process that minimises e NGET’s discretion.

We strongly support an efficient appeals mechanism for decisions: NGET should have no role in dispute resolution or determining appeals.

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.

Response:

Yes, in our opinion the degree of business separation requirement that already exists is understated in the consultation. NGET is subject to a number of controls through:

- Legislation (the Electricity Act 1989 that sets out statutory obligations, competition law that prohibits NGET from acting in a discriminatory way, and the Utilities Act 2000 which applies controls to management and use of information that we receive),
- Regulation: NGET is regulated through licence enforced by Ofgem.
- Industry codes that govern market operation are subject to industry wide governance procedures overseen independently by Ofgem; and
- Reporting: NGET is required to report annually to Ofgem on how existing separation measures are complied with and compliance will be further bolstered from 2 April 2014 by a requirement to have 2 independent non-executive directors on its Board.

In addition, the Energy Bill sets out provisions under which the Secretary of State has powers to increase the degree of separation between the EMR role and other NGET roles, if he considers it to be necessary or desirable, up to and including giving the Delivery Body role to someone else. In exercising this power he must have regard to the extent that such measures may affect the efficient and effective carrying on of the EMR function, the SO functions (as currently set out in NGET's licence) and another functions authorised under the Licence. The Licence could also be bolstered to include a requirement to report annually on how separation measures are complied with.

In addition to these regulatory requirements, National Grid's Group Structure already mitigates against conflicts arising since NGET is a separate legal entity and has separate board and governance arrangements from its Interconnector business, CCS, NGOL and LNG. Further information on these rules is set out in Annexes 2, 3 and 4.

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

As set out above existing overarching rules on business separation in statute and in NGET's licence will apply to NGET's EMR role. These will already ensure that NGET will not pass EMR specific information to businesses outside NGET. We are mindful that some new information received through EMR will be commercially sensitive and as a matter of commercial good practice and in the interests of market participant confidence it should be treated as a special case. We therefore support amendments to NGET's licence which will require that EMR specific information should be held separately and be accessible only to the EMR Team for use only for EMR purposes.

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

No

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

As set out above we do not believe that any business separation beyond restrictions on information flows is necessary.

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

No more than currently exists. Explicit licence conditions to protect EMR Specific Information from

being passed to non-NGET businesses or to the SO/TO functions would reinforce existing prohibitions.

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

Response:

TO/SO synergies also need to be protected. Even if NGET were not the EMR Delivery Body the SO and TO functions in NGET may still require access to certain information (agreed and specified by Ofgem once this level of detail is known) associated with the CM and CfD mechanisms in order to enable those functions to be economically and efficiently conducted by NGET in accordance with its licence and statutory obligations. Ofgem would require access to this information to be given to NGET so that it could be satisfied that NGET was appropriately discharging its obligations to develop, plan and operate the system. To avoid duplication, there will be efficiencies in certain SO employees having access to specific information for modelling purposes, but they should be prohibited from sharing EMR specific information with anyone else or using it for any non-EMR purpose. Beyond that we anticipate that all EMR Specific Information would be protected so that neither the SO or the TO would have access to it.

There should be no new prohibitions on use of EMR information that NGET already gets and that it receives a second time through the EMR process.

Annex 2

Summary of existing controls

As the largest electricity Transmission Company in Great Britain NGET is subject to regulatory and statutory rules which govern the way in which it carries on its business:

1. Competition Law

Like any other company, National Grid is subject to the requirements of Competition Law in the form of the Competition Act 1998. Chapter 1 of that Act prohibits National Grid from entering into anti-competitive agreements, while Chapter 2 prohibits relevant National Grid companies (which includes NGET) from abusing a position of dominance in a relevant market.

For the purposes of competition law NGET is defined as dominant in the transmission of electricity in England and Wales and in electricity system operation in Great Britain. The abuse of dominance provisions require NGET to operate fairly where it is in a position to distort competition: as with Special Condition C1 of NGET's licence, this could include using information which it receives for one purpose to confer an unfair commercial advantage on itself or on another company in the National Grid group.

2. Electricity Act 1989 (EA89)

Part 1 Section 9 of the EA89 requires NGET, as a holder of an electricity transmission licence, to develop and maintain an efficient, co-ordinated and economical system of electricity transmission and to facilitate competition in the supply and generation of electricity. NGET will need to have both these statutory obligations in mind when carrying out its activities in relation to the transmission of electricity when carrying out the EMR functions.

The EA89 also, through implementing the Third EU Energy Package, prohibits NGET and its group companies from carrying out any activities that would require either a generation or supply licence. As such, NGET and the National Grid group of companies generally is prohibited from engaging in the kinds of activities that EMR is targeted at.

3. Utilities Act 2000, s105

Section 105 applies to NGET as the holder of an electricity transmission licence and prohibits NGET from disclosing information obtained in the course of its licensed activities and which relates to the affairs of individuals or businesses to any third party including other companies in the National Grid group. This obligation lasts for as long as the person to whom the information relates carries on business and is not limited to confidential information: rather it extends to all information that NGET has obtained by virtue of its licensed activities.

This obligation is backed up by criminal sanctions for breach.

4. NGET's Electricity Transmission Licence

NGET holds a licence to participate in the transmission of electricity under EA89 s6(1)(b). The licence manages the way in which NGET can operate setting out rules relating to its financial management,

regulatory accounts, management of information and business separation. This includes an over-arching obligation on NGET to conduct its transmission business in such a way so as to secure that NGET, its affiliates, any users of the transmission system and other transmission licensees obtain no unfair commercial advantage (Special Condition C1). This will include using information that it obtains for one purpose to confer an unfair commercial advantage on itself or on another company in the National Grid group. These obligations may be summarised as follows:

Limitations on Scope of Activity

Condition B6 limits the scope of the licensee's activities and ensures that assets of the regulated business are not put at risk. It also ensures that NGET cannot engage in activities outside of the transmission business (except in a very limited manner or with the Authority's consent).

Condition B9 protects the assets of the licensed business for use in the licensed business and through imposing an obligation to deal on an arm's length basis on normal commercial terms backs up an obligation not to give or receive any cross subsidy (as this would not be normal commercial terms). As it is not limited merely to financial terms, it also prohibits NGET from favouring other group companies as such favouritism could not be achieved if NGET were acting on an arms length basis and normal commercial terms.

Obligations Requiring Economic and Efficient Behaviour (in addition to EA89, s9)

Condition C16 requires NGET to operate its system in an economical and efficient manner and prohibits undue discrimination between any persons or classes of person in the procurement or use of balancing services. By requiring NGET to act in a particular manner, in the conduct of the SO function, it guards against it favouring other National Grid businesses, as such behaviour would be in conflict with the requirement to act economically and efficiently. This reinforces the obligation in s9 of the EA89 requires the economic and efficient maintenance and development of the transmission system).

Obligations prohibiting discriminatory behaviour

Standard Conditions C7 contains a general non-discrimination rule providing for fundamental principles for the way in which the licensee should conduct itself in the provision of connection and use of system. This clearly prohibits behaviour that would favour NGET or a group company.

Special Condition C1 imposes a wide obligation on NGET to conduct its transmission business in a manner that confers no unfair commercial advantage on itself, affiliates, transmission users and transmission licensees and in addition prevents NGET or any subsidiary of NGET from holding an OFTO licence in order to prevent any discrimination between commonly held transmission licences.

Special Conditions C2 and C3 bolster Special Condition C1 by requiring licensees to have specific managerial and operational architecture to ensure compliance. This includes the appointment of a Business Separation Compliance Officer to facilitate compliance with certain licence conditions and a requirement for the appointment of a sub-committee of the board to oversee and ensure performance of the duties and tasks of the Compliance Officer.

Special Conditions G, M and N ensure that NGET does not favour its own transmission asset over any other transmission asset owned by another party, in particular by placing restrictions on the use of information.

Prohibition on Cross Subsidies

Standard Condition B5: Linked to the obligation to report under Condition B1; together these provisions ensure costs/revenues of group companies are attributed to the business that gives rise to them. This backs up the prohibition on favouring other businesses.

General “Good Conduct” obligation

Standard Condition B8 extends the general good conduct obligation to group companies. The undertaking required to be given by National Grid plc ensures that no conduct by other group companies will place NGET in breach of its licence obligations.

General Reporting

Standard Condition B1 requires the production of regulatory accounts and thereby ensures transparency that revenues/costs attributable to the licensed business area are applied for that business and backs up the general prohibitions, preventing misallocations of costs and revenues and the grant and receipt of cross subsidies.

Standard Condition B7 seeks to ensure that there are sufficient resources to allow the transmission business to be run and again ensures that the licensee concentrates on its licensed activities (which must be run in accordance with the other protections/obligations).

Standard Condition B16 Secures the collection of specified information to an appropriate degree of accuracy so that Ofgem can monitor effectively the revenue of the licensee; this ensures effective regulatory oversight can be maintained by the Authority.

5. Industry Codes

The CUSC, Grid Code, STC and BSC, contain certain general restrictions ensuring that information that NGET receives as part of its regulated business be treated as confidential and be used only for the purpose of performing its activities. The codes to be developed to support EMR can include similar provisions. These are backed by licence conditions requiring NGET to comply with the codes which ensure that NGET is subject not only to contractual remedies, but also regulatory remedies in order to ensure compliance with its confidentiality obligations under these codes.

A table providing more detail on each of these licence conditions and their applicability to National Grid group businesses is at Annex A1.

Annex 2.1

Business Separation - Existing Provisions in the NGET Licence and how they apply to interactions with other National Grid Group Companies and Third Parties

Type of Separation provision	Licence Condition	Summary of obligation	External Audit carried out	Covered in reports to Ofgem	National Grid Offshore Ltd	National Grid Interconnectors Ltd	National Grid Carbon	Britned	Grain LNG Ltd	National Grid Gas (NTS)	National Grid Gas (RDN)	Gas storage and LNG	Third Parties
Financial	Condition B1 – Regulatory Accounts	<p>Para 3 (viii) contains an obligation for a statement showing amounts of revenue, cost, asset, liability, reserve or provision which has been:</p> <p>(aa) Charged from any ultimate controller of the license together with any subsidiary of such ultimate controller (other than the licensee or its subsidiaries), in relation to the provision of goods or services to the license;</p> <p>(bb) Charged from the licensee together with any subsidiary of the licensee in relation to the provision of goods or services to any ultimate controller of the licensee together with any subsidiaries of such ultimate controller (other than the licensee or its subsidiaries); or</p> <p>(cc) determined by apportionment or allocation to the consolidated transmission business or between any other business of the license or affiliate or related undertaking together with a description of the basis of the apportionment or allocation; and</p> <p>(dd) where applicable, revenue from the ownership of the transmission network.</p> <p>Para 8, requires that the audit conducted under para 7 verifies whether the obligation to avoid discrimination and cross subsidies specified in Article 31 of the Electricity Directive has been respected.</p> <p>Comment - ensures transparent attribution of revenues/costs applicable to licensed business area are applied for that business and backs up the general prohibitions preventing misallocations of cost and revenues and the grant and receipt of cross subsidies</p>	√	√	√	√	√	√	√	√	√	√	
Financial	Condition B5 – Prohibition of Cross Subsidies	<p>The license shall procure that the transmission business shall not give any cross subsidy to, or receive any cross subsidy from, any other business of the licensee or of an affiliate or related undertaking of the licensee.</p> <p>Comment – This backs up the prohibition on favouring other businesses. Linked to obligation to report under Condition B1 together these provisions ensure costs/revenues of group companies are attributed to the business that gives rise to them.</p>	√ as part of audit under B1 described above	√	√	√	√	√	√	√	√	√	
Financial	Condition B6 Restriction on activity and financial ring fencing:	<p>The licensee shall not conduct any business or carry on any activity other than the transmission business, deminimis business within the defined thresholds, or any activities where Ofgem has granted a consent.</p> <p>Comment - limits the scope of the licensees 'activities and ensures that assets of the regulated business are not put at risk. It also ensures that NGET cannot engage in activities outside of the transmission business (except in a very limited manner or with the Authority's consent) which might lead to conflicts with the EMR function.</p>	√ under B16	√ under B16 reporting √ certification under B7	√	√	√	√	√	√	√	√	√
Financial	Condition B7 – Availability of Resources	<p>Seeks to ensure sufficient resources to allow the transmission business to be run (and so not at risk from other businesses)</p> <p>Requires reporting to Ofgem accompanied by an auditors statement</p> <p>Requires certification ahead of dividend payment and so prevents money leakage</p> <p>Comment: ensures that the licensee concentrates on its licensed activities (which must be run in accordance with the other protections/obligations.</p>	√	√	√	√	√	√	√	√	√	√	

Type of Separation provision	Licence Condition	Summary of obligation	External Audit carried out	Covered in reports to Ofgem	National Grid Offshore Ltd	National Grid Interconnectors Ltd	National Grid Carbon	Britned	Grain LNG Ltd	National Grid Gas (NTS)	National Grid Gas (RDN)	Gas storage and LNG	Third Parties
Legal	Condition B8 - Undertaking from ultimate controller	Requires that ultimate controller to undertake to ensure that neither it nor any of its subsidiaries refrain from action which could cause NGET to be in breach of its licence conditions. Comment - General “good conduct” obligation on behalf of the whole group that backs up all other obligations and bolsters “the other end” eg of non discrimination/no cross subsidy obligations.		√ certification under B7	√	√	√	√	√	√	√	√	
Financial and Legal	Condition B9 – Indebtedness	The licensee shall not without prior written consent of Ofgemtransfer, lease, license or lend any sum or sums asset, right or benefit to any affiliate or related undertaking of the licensee otherwise than by way ofpayment properly due for any goods, services or assets provided on an arm’s length basis and on normal commercial terms. Comment - Protects assets of licensed business for use in the licensed business and through imposing obligation to deal on ALBNCT backs up obligation not to give or receive cross subsidy (as this would not be normal commercial terms). Note the cash lock up provisions detailed in paragraphs 3 and 4 which would apply if the licensee does not hold an investment grade issuer credit rating or if the credit rating is on review for possible downgrade, on credit watch or rating watch with a negative description or has a negative rating outlook. As it is not limited merely to financial terms, this obligation also, therefore, prohibits NGET from favouring other group companies as such favouritism could not be achieved if NGET were acting on an “arm’s length basis and normal commercial terms.		√ certification under B7	√	√	√	√	√	√	√	√	√
Financial	Condition B16 – Price Control Revenue Reporting and Associated Information	The purpose of this condition is to secure the collection of specified information, to an appropriate degree of accuracy by the licensee so as to enable the Authority to monitor effectively the revenue of the consolidated transmission business. Comment: ensures effective regulatory oversight can be maintained by the Authority.	√	√	√	√	√	√	√	√	√	√	√
Legal, Financial, Physical, Employee, Information	Special Condition C1: Prohibited Activities and Conduct of the Transmission Business	Except with the written consent of the Authority, the licensee shall not and shall procure that any subsidiary of the licensee shall not, ... hold or seek to hold, a transmission licence that has Section E (Offshore Transmission Owner Standard Conditions) in effect The licensee shall conduct its transmission business in the manner best calculated to secure that, in meeting its obligations under the licence: the licensee, any affiliate or related undertaking of the licensee (including participants in competitive tender exercises related to granting of Offshore transmission licences), any user of the National Electricity Transmission System or any other transmission licensee obtains no unfair commercial advantage including, in particular any such advantage from a preferential or discriminatory arrangement, being, in the case of such an advantage accruing to the licensee, one in connection with a business other than its transmission business. Comment – Prevents NGET or any subsidiary from holding an OFTO licence in order to prevent any discrimination between commonly held transmission licences and also imposes a wide obligation on NGET to conduct its transmission business in a manner that confers no unfair commercial advantage on itself, affiliates, transmission users and transmission licensees.		√	√	√	√	√	√	√	√	√	√

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Type of Separation provision	Licence Condition	Summary of obligation	External Audit carried out	Covered in reports to Ofgem	National Grid Offshore Ltd	National Grid Interconnectors Ltd	National Grid Carbon	Britned	Grain LNG Ltd	National Grid Gas (NTS)	National Grid Gas (RDN)	Gas storage and LNG	Third Parties
Legal, Financial, Physical, Employee, Information	Special Condition C2 Separation of NGET and Relevant Offshore Transmission interests	<p>The licensee shall, in carrying out its licensed activities, put in place an at all times maintain such systems of control and other governance arrangements which are necessary to ensure the licensee complies with the obligations contained in Standard Condition B5, Standard Condition B6 and Special Condition C1.</p> <p>...the license shall ... have in pace a statement approved by the Authority describing the practices, procedures and systems which the license has adopted (or intends to adopt) to secure compliance with paragraph 1.</p> <p>The statement shall in particular (but without prejudice to the generality of paragraph 1) set out how the licensee shall:</p> <p>a) maintain appropriate managerial and operational independence of the license in undertaking its activities under this licence from any relevant offshore transmission interest:</p> <p>b) secure that no breach of Standard Conditions B5, B6 and Special Condition C1 occur as a result of any arrangements for access by any relevant offshore transmission interest or by any person engaged in or in respect of the relevant offshore transmission interest with respect of:</p> <ul style="list-style-type: none">▪ Premises ...▪ Systems for recording, processing or storage of data ...▪ Equipment facilities or property ...▪ Services of persons ... <p>c) manage the transfer of employees from NGET to any relevant offshore transmission interest.</p> <p>Managerial and operational independence shall include separate managerial boards for the system operator and the relevant offshore transmission interest.</p> <p>Appointment of a “responsible director” with day to day responsibility for maintaining managerial and operational independence of the licence.</p> <p>Comment - Bolsters C1 obligation by requiring licensee to have specific managerial and operational architecture to ensure compliance.</p>		√	√	√	√	√	√	√	√	√	
Legal, Financial, Physical, Employee, Information	Special Condition C3 – Appointment and duties of Business Separation Compliance Officer	<p>Requirement for a Business Separation Compliance Officer to be appointed to facilitate compliance with Standard Condition B5, Standard Condition B6, Special Condition C1 and Special Condition C2.</p> <p>Requirement for a compliance committee (being a sub-committee of the board of directors) to oversee and ensure performance of the duties and tasks of the business separation compliance officer.</p> <p>Requirement for any relevant complaints or representations to be passed to the BSCO.</p> <p>Duties and tasks include:</p> <ul style="list-style-type: none">▪ Providing advice and information ...▪ Monitoring ...▪ Advising on implementation ...		√	√	√	√	√	√	√	√	√	√

		<ul style="list-style-type: none"> Investigating complaints ... Recommending and advising upon the remedial action ... Providing relevant advice ... Reporting to the compliance committee <p>Requirement to report to Ofgem annually on compliance.</p> <p>Comment - Bolsters C1 obligation by requiring licensee to have specific managerial and operational architecture to ensure compliance.</p>											
Type of Separation provision	Licence Condition	Summary of obligation	External Audit carried out	Covered in reports to Ofgem	National Grid Offshore Ltd	National Grid Interconnectors Ltd	National Grid Carbon	Britned	Grain LNG Ltd	National Grid Gas (NTS)	National Grid Gas (RDN)	Gas storage and LNG	Third Parties
Information	Special Condition M – Restriction on the use of certain information	<p>Condition applies where the licensee has received an application for connection pursuant to paragraph 1(b) of standard condition C8 (Requirement to offer terms) from any person (the "applicant"), in relation to a possible connection to the national electricity transmission system in an area which is outside the licensee's transmission area.</p> <p>Where the condition applies any information received from another transmission licenseebe treated as confidential relating to the design, construction, financial matters or any information derived from the possible connection until such time as the licensee accepts the TO offer relating to that connection or the applicant accepts an alternate offer. Note exceptions in paragraph 4.</p> <p>The licensee shall ensure that any confidential information is not to disclosed to or used by those of its employees, agents, advisers, consultants or contractors who are responsible for, or are otherwise involved in any way in the preparation of any alternative offer ... The licensee shall further ensure that such of its employees, agents, advisers, consultants or contractors who are preparing an offer for the applicant dealing with such confidential information shall not have access to any information derived from or relating to any alternate offers being prepared for or which have been made to the applicant in relation to a possible connection or possible connections to any part of the national electricity transmission system which falls within the licensee's transmission area.</p> <p>Comment – Role designed to ensure that the licensee does not favour its own asset owning activity over that of the Scottish licensees by sharing of information. Targeted rule to deal with specific concern dealing with concurrent applications from one user for alternative connections in England & Wales and Scotland.</p>		√	√	√	√	√	√	√	√	√	√
Information	Special condition N	<p>Requirement for a compliance statement describing how the licensee shall ensure compliance with special condition M.</p> <p>Requirement for appointment of a compliance officer who will carry out duties and tasks including those defined in paragraph 8 which include:</p> <ul style="list-style-type: none"> Providing advice Monitoring Investigating any complaint received in relation to Special Condition M or Special Condition G. Recommending and advising on remedial action. Providing advice and information to ensure implementation of practices, procedures and systems adopted in accordance with the compliance statement. <p>Requirement to report annually to the directors of NGET and to submit a compliance report to Ofgem.</p> <p>Comment – Provides the compliance architecture to bolster Special Condition M</p>		√	√	√	√	√	√	√	√	√	√
Legal, Financial, Information	Special Condition G – Prohibition on engaging in preferential or discriminatory behaviour	<p>Requirement for NGET not to unduly discriminate or unduly prefer any other transmission licensee or itself over any other transmission licensee(s) in meeting its obligations under the licence.</p> <p>Comment – Imposes a broad prohibition on undue discrimination between transmission licensees when conducting the transmission business.</p>											√
Legal, Financial, Information	Condition C7 - prohibition on discriminating between users	In the provision of use of system or in carrying out works for the purpose of connection to the national electricity transmission system, the licensee shall not discriminate as between any persons or class or classes of persons.		√	√	√	√	√	√	√	√	√	√

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		<p>The licensee shall not in setting use of system charges restrict, distort or prevent competition in the generation, transmission, supply or distribution of electricity or in the participation of the operation of an interconnector.</p> <p>Comment – General non discrimination rule provides for fundamental principles for the way the licensee should conduct itself.</p>											
Type of Separation provision	Licence Condition	Summary of obligation	External Audit carried out	Covered in reports to Ofgem	National Grid Offshore Ltd	National Grid Interconnectors Ltd	National Grid Carbon	Britned	Grain LNG Ltd	National Grid Gas (NTS)	National Grid Gas (RDN)	Gas storage and LNG	Third Parties
Legal Financial Information	Condition C16 – Procurement and use of balancing services	<p>Requires NGET to operate the transmission system in an economical and efficient manner. Having taken into account relevant price and technical differences, the licensee shall not discriminate as between any persons or classes of persons in its procurement or use of balancing services.</p> <p>Comment: by requiring NGET to act in a particular manner, in the conduct of its SO function, it guards against it favouring National Grid businesses, as such behaviour would be in conflict with the requirement to act economically and efficiently. As such it complements the obligation in section 9 of the Act which guards against conflicts with the TO function.</p>	√	√		√		√					√

Other Relevant Legislation

Legislation	Summary of obligation	External Audit carried out	Covered in reports to Ofgem	National Grid Offshore Ltd	National Grid Interconnectors Ltd	National Grid Carbon	Britned	Grain LNG Ltd	National Grid Gas (NTS)	National Grid Gas (RDN)	Gas storage and LNG	Third Parties
Utilities Act (Section 105)	<p>Section 105 of the Utilities Act 2000 places a general criminal prohibition on licensees (including NGG and NGET) from disclosing information which relates to the affairs of (i) individuals or (ii) any particular business to any third party (including other companies within the same group as the licensee holding the information) which they have obtained in the course of their licensed activities. There are certain exceptions to this rule, such as where consent has been obtained from the individual or business who provided the information or where information is required to be disclosed by a condition of a licence. However, a large amount of the information that NGET and NGG receive as part of their licensed activities will not fall within the exemptions and so will be caught by the provisions of section 105 of the Utilities Act 2000.</p> <p>Comment – General statutory prohibition on the disclosure of information whether confidential or not. Prohibits information exchanges that could give rise to concerns for example around discrimination.</p>			√	√	√	√	√	√	√	√	√
Competition Law	<p>Prohibits monopoly companies from entering into anti-competitive agreements or from abusing their market position through anti-competitive behaviour.</p> <p>Comment – General rules relating to conduct of all businesses provide ex post regulation to deal with problems should ex ante sectoral legislation have failed to deliver appropriate behaviour.</p>			√	√	√	√	√	√	√	√	√
Industry Codes - CUSC, Grid Code or BSC	<p>The codes, in general, provide that information NGET receives as part of the regulated business must be treated as confidential, and only used to enable NGET to perform their respective regulated activities. There are certain exemptions, such as where the information is already in the public domain or the owner of the information has given its consent to the information being published.</p> <p>Disclosure of information in breach of the CUSC, Grid Code or BSC would also place NGET in breach of its licence since the licence contains obligations requiring compliance with the CUSC and BSC.:</p>											

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Legislation	Summary of obligation	External Audit carried out	Covered in reports to Ofgem	National Grid Offshore Ltd	National Grid Interconnectors Ltd	National Grid Carbon	Britned	Grain LNG Ltd	National Grid Gas (NTS)	National Grid Gas (RDN)	Gas storage and LNG	Third Parties
Electricity Act	<p>Part 1 Section 9 - General duties: It shall be the duty of the holder of a licence authorising him to transmit electricity—</p> <p>(a)to develop and maintain an efficient, co-ordinated and economical system of electricity transmission; and</p> <p>(b) to facilitate competition in the supply and generation of electricity.</p> <p>Comment – General statutory duty, requiring NGET to act in a particular manner in the conduct of its transmission business. As such, it guards against it favouring other National Grid businesses; as such behaviour would be in conflict with the requirement to act economically and efficiently.</p>			√	√	√	√	√	√	√	√	

Annex 3

Background to Introduction of Special Condition C1

In this Annex we set out the basis of our interpretation of Special Condition C1 which we note is more onerous than the interpretation placed on it in the consultation. Special Condition C1 was added to NGET's licence on Ofgem's direction in June 2009 in response to Ofgem's decision to hold competitive tenders for the provision of OFTOs. Whilst it does make specific reference to OFTOs it does, in fact, relate to any company that is a subsidiary of, or controlled by, National Grid plc (paragraph 2). Much of the text in paragraph 2 does relate to OFTOs ((b)(i) & (ii)), but that is inserted for the avoidance of doubt and does not detract from the overriding point that C1 relates *inter alia* to all affiliates and related undertakings of NGET as well as NGET itself.

Special Condition C1 is closely modelled on Standard Special Condition A6 of gas transmission and distribution licences ("SSpC A6") which has formed part of those licences for many years, in its current form since May 2005 when National Grid sold some of its gas distribution networks. It is deliberately broadly drafted to ensure that all types of business behaviour are captured. We interpret Special Condition C1 as being the "electricity equivalent" of SSpC A6.

Limiting the interpretation of Special Condition C1 to charging matters only would be a very narrow interpretation which we do not believe is supported either by the wording of the condition or the annual compliance report.

Our interpretation is supported by the documentation which was published when the amendments were being made to NGET's licence. The first is the joint Ofgem/DECC consultation on proposed changes to the Special Conditions. The link to the document is:

(<http://www.ofgem.gov.uk/Networks/offtrans/pdc/cdr/cons2008/Documents1/Annex%209%20NGET's%20Special%20Licence%20Conditions.pdf>). Page 2 of Annex 9 summarises the changes made and in respect of Special Condition C1 it says "*The condition is intended to prohibit the licensee giving any other party an unfair commercial advantage through a discriminatory business practice.*" Thus it is clear that the stated purpose of the condition at the time it was introduced into NGET's licence was at no stage limited to charging arrangements but applied to any discriminatory business practice.

The second is Ofgem's notice of modifications made pursuant to Section 11 Electricity Act 1989, the link to which is:

(<http://www.ofgem.gov.uk/Networks/offtrans/pdc/cdr/cons2009/Documents1/Modification%20pursuant%20to%20Section%2011.pdf>). Paragraph 2(a) refers back to the joint consultation and confirms that it proposed to modify the Licence by adding: "*Special Condition C1 (Prohibited Activities and Conduct of the Transmission Business) to prevent the licensee from holding, or seeking to hold, a transmission licence that has section E standard conditions in effect, and ensure that the licensee conducts its business in such a manner that it gives no other party an unfair commercial advantage.*" Paragraph 3 expands on this "...the reasons for the decision of the Authority to modify the Licence are that business separation between the licensee and any party wishing to become an offshore transmission owner is required since the licensee has access, and will continue to have access, to information that would be advantageous to any party preparing to bid for an offshore transmission licence and without such safeguards the licensee could enable a party to gain an unfair advantage over its competitors."

The reason for the introduction of C1 into NGET's licence was the development of OFTOs and the possibility that NGET could use information that it had to the advantage of certain players but Ofgem took the opportunity to close off any possible gaps in the NGET licence which might have permitted NGET to confer an advantage on affiliates or third parties (or on itself) without breaching its licence. (Note also

that NGET is bound by competition law and even without Special Condition C1 misuse of information to confer an advantage would arguably be a breach of Chapter 2 Competition Act and possibly Article 102 TFEU). The important point here, however, is that Ofgem clearly considers that an unfair commercial advantage can be conferred through misuse of information.

It should also be remembered that this condition was added in addition to the pre-existing conditions which made it clear that NGET must not engage in discriminatory activities in relation to connection to or use of the transmission system or in the procurement and use of balancing services: see conditions C7 (Prohibition on discriminating between users) and C16 (Procurement and use of balancing services) of NGET's transmission licence. NGET considers that these conditions themselves for practical purposes controlled any informational, behavioural or financial discrimination by NGET in the conduct of its transmission business, but was happy to have the position clarified by the introduction of the "catch all" provision of special condition C1.

NGET submits a Compliance Annual Report to Ofgem on the framework, controls and processes in place to ensure that NGET does not provide an unfair advantage contrary to Special Condition C1. In line with our interpretation of C1 this report specifically refers to controls that are in place to prevent an unfair commercial advantage being given through sharing of commercially sensitive information about third parties or any other NGET data that is not in the public domain or shared equally with other parties. It also talks about the restrictions on NGET systems to prevent access by or to information by other group companies.

Annex 4

Sufficiently Independent Directors

On 17 December 2012 the Gas and Electricity Markets Authority issued a statutory notice that it proposed to modify the ring fence conditions within the licences of all network operators, including the transmission licence of NGET. One of the proposed modifications is to introduce a new licence condition in respect of the requirement for sufficiently independent directors ("SIDS"). The statutory consultation closes on 22 January 2013 and, if the Authority decides to make the proposed changes, they will take effect not less than 56 days later.

The effect of the independent director condition is to require the licensee to have at least two non-executive directors on the NGET Board by 1 April 2014 who meet the "sufficiently independent director" criteria set out in the licence condition. Such criteria are that the director has the necessary skills, knowledge and experience to act as a non-executive director, has no executive duties within the licensee's business, must not be an employee of the licensee or a director or employee of an associate of the licensee and must not have been so during the 12 months prior to appointment.

The process under which the Authority reached its decision to introduce SIDs was:

- In its March 2011 consultation on the proposals, Ofgem stated that it considered that "SIDS should be able to make a positive contribution to good governance, particularly in promoting the importance of licence compliance ("letter and spirit") which is central to the [network operator's] business. Our proposal is also consistent with the view that it is for the owners and directors of [network operators'] to manage licence compliance and financial stability issues and that more interventionist regulatory measures are undesirable";
- In the same March 2011 document Ofgem also stated that "our proposals relate to a concern that there should be non executive representation on [network operator] boards which can provide an un-conflicted perspective on the [network operator's] interests, including in relation to licence compliance, in all circumstances". It also stated "SIDS should therefore always be in a position to provide a "voice of reason" at board meetings in relation to the needs of the [network operator]"; and
- In its October 2012 consultation on the proposals Ofgem stated that "a [SID] should be in a position to express views, with respect to the licensee company in particular, from a perspective that is less constrained by formal duties to consider the interests of other entities which might be affected by a "bigger picture", extending outside of the network group, involving commercial or operational opportunity or adversity"

These statements seek to justify the need for the appointment of SIDs on the basis, inter alia, that they will be able to provide independent and unbiased views and assessment in relation to the licensee's compliance with licence conditions.

As stated elsewhere in this response, the Electricity Act 1989 and the NGET licence already contain a raft of provisions which prevent the licensee from behaviour that restricts competition in the generation and supply of electricity, that is discriminatory in nature and that confers any unfair commercial advantage. Via the ultimate controller undertaking condition of the licence, other group companies are also prohibited from acting in a manner that may place the licensee in breach of its statutory and licence obligations. We believe that these existing provisions combine to require NGET and its directors to conduct the licensed business in such a way as to avoid such behaviour at all times, including where such behaviour may arise in

the context of a real or perceived conflict of interest. Such provisions will continue to apply equally in respect of the conduct of the EMR functions as and when these become licence obligations.

To the extent that existing safeguards such as the operation of the Board's compliance committee and the annual certificate provided to Ofgem (approved by a resolution of the board and signed by a director) in relation to the licensee's compliance with the relevant business conduct licence conditions do not provide sufficient assurance as to the compliant conduct of the licensee's business, then the introduction of SIDs to the NGET Board will, by Ofgem's own repeated assertions, provide a "voice of reason" and an additional layer of assurance to Ofgem when NGET is considering and reporting on its compliance with relevant business conduct licence obligations.

It is anticipated that the two SIDs will have been appointed to the NGET Board in accordance with the new licence condition by 1 April 2014. Accordingly they will be in place and be in a position to provide the independent assessment at Board level (and to Ofgem via the annual certificate) as to NGET's compliance with relevant business conduct conditions prior to the EMR functions and associated licence obligations being conferred on NGET.

Annex 5

Analysis of information

Information received through the EMR process can be divided into 3 categories:

- i. Information that is wholly new to NGET;
- ii. Information that NGET already receives for other purposes but which is provided in more detail; and
- iii. Information that NGET already receives for other purposes and which is duplicated through the EMR process

1. Our current view is that information received through the EMR function will include:

- a. *Project specific generation costs*: estimates of generation costs on generic terms are already received by NGET so this is an example of information that will be received in greater detail through the EMR role.
- b. *DECC demand forecasts which are not in the public domain*: again these are already available to NGET at a certain level, but may be available in more detail through the EMR role,
- c. *DECC's Dynamic Despatch Model (DDM)* which is similar to the generation despatch model currently used by NGET for power generation scenarios and system planning;
- d. For the Capacity Mechanism (CM) bids *the value that individual generation units place on fixed costs* rather than energy: this is an example of EMR specific information that is not currently available to NGET. However it is not expected that NGET will have access to the plans themselves, merely the fact that a plan has been lodged with DECC or Ofgem ;
- e. For CM *credit references* relating to ability to pay a penalty if the CM provider fails to deliver. NGET already obtains credit references for other purposes under the CUSC, so this is an example of information that may already be collected for another purpose, which is duplicated through the EMR process.
- f. For CM price setting for the auction, *business plans* will be required to support bids: this is an example of wholly new information received specifically for EMR purposes;
- g. For CM the outcomes of modelling of the *capacity needed* to deliver DECC's reliability model; NGET already carries out similar modelling for TO and SO purposes;

2. Of these:

- (a) project specific generation build costs, (f) CM price setting business plans and (g) part of the CM modelling outcomes (i.e. the potential cost) are not relevant to system operation⁶ and should be segregated and protected so that they are accessible only by the EMR Team;
- (b) unpublished demand forecasts, (c) the DDM and (g) the other part of CM capacity modelling (ie amount needed) are relevant to system operation and transmission system management. More accurate and consistent demand forecasting will assist with more efficient system operation and transmission investment which in turn reduces costs to consumers. In respect of the DDM and CM modelling (capacity adequacy) NGET may use this model in place of its current scenario development model. This could support consistency in outcomes and does not create a conflict.

⁶ We understand that concern has been expressed that having access to detailed information on generation costs might enable the SO, when assessing Balancing Services contracts, to negotiate a lower price – however the SO assesses such contracts on a Cost of Alternative basis, so generation costs are not relevant.

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3. Information that NGET already receives but which may be duplicated through the EMR process includes:
 - a. For CM, holding planning consents and connection offers will be criteria relevant to CM qualification. The TSO already receives this information as part of the connection process;
 - b. Where a CM obligation is traded (secondary trading) the SO will be notified of where the obligation lies (but not the price of the relevant trade). Generators are already required to provide similar information to the SO under OC2 of Grid Code;
 - c. For the CM process NGET will receive information about the technical characteristics of specific generation plant. This information is already provided to the TO and SO as part of the connection process.
 4. EMR Specific Information may itself fall into more than one category. There will be some (e.g. specific build costs) which we believe should remain permanently confidential, but there will also be some that it may be helpful to the industry at large and in the interests of transparency to publish. We believe that industry participants in EMR should be fully consulted on this point as the detail of precisely what information is involved becomes clearer.

Annex 6

Competitive Businesses – no new conflicts

Our specific comments on the analysis in the consultation for each of National Grid’s “competitive” businesses is:

- a. *NGOL* – The crucial step for offshore transmission build is when a licence is awarded by Ofgem following a competitive process so it is not clear that early access to information could give NGOL more time to better position itself. We do nonetheless agree that NGOL should not have access to EMR information, just as under Special Condition C1 it has no special access to SO/TO information that might confer an unfair commercial advantage. We consider that the present regulatory regime already achieves this.
- b. *Interconnectors*: the risk identified, that early access to information, could give an advantage is unrealistic – the lead times for such major development are so long that there can be no advantage in slightly earlier access to information. It is not in any case clear how the example given in paragraph 71, that the “distortion of competition” could impact negatively on consumers can be right: if the investment is not efficient then shareholders will bear the loss: consumer risk would only apply if the costs were socialized. We nonetheless agree that National Grid’s interconnector business should not have special access to EMR information, just as under Special Condition C1 it has no special access to SO/TO information that might confer an unfair commercial advantage; We consider that the present regulatory regime already achieves this.
- c. *CCS* – this is an unproven technology which currently depends on winning a Treasury competition so early access to information is irrelevant. We do, however, agree that it should not have access to EMR information just as under Special Condition C1 it has no special access to SO/TO information that might confer an unfair commercial advantage. We consider that the present regulatory regime already achieves this;
- d. Gas LNG importation⁷: investment decisions have been based on running an open season, negotiating long-term contracts with interested parties and then seeking an exemption from rTPA rules under Article 36 of Directive 2009/73EC so these projects are customer led. Given the protracted timescale for these (several years), the fact that a gas shipper is unlikely to commit to capacity in the open season unless they have contracts in place with customers and such customers will not contract with a shipper until they know the outcome of the relevant CM process, it is hard to see how in practice a conflict could arise. So there is no realistic advantage in having early information about strike prices. Again, however, we agree that, as a matter of good commercial practice (and in accordance with NGET’s licence conditions) that National Grid’s LNG importation business should not have access to EMR information before it is published; We consider that the present regulatory regime already achieves this

⁷ LNG physically stored at Grain is imported and held temporarily prior to being delivered to the gas national transmission system (NTS): this “storage” is technically necessary as part of the operation of the LNG importation facility: therefore Grain is not a “storage” facility for the purposes of the Gas Act 1986.

- e. Gas LNG storage: National Grid has only a very marginal interest in gas storage through a single over ground facility that exists for transmission reasons and which is scheduled to close in 2018. We can see no way in which having access to EMR information could in practice be of any benefit to the LNG storage business. Nonetheless, we agree that, as a matter of good commercial practice (and in accordance with NGET's licence conditions) that National Grid's LNG storage business should not have access to EMR information before it is published. We consider that the present regulatory regime already achieves this

Annex 7

Analysis of Potential EMR/TO conflicts

In respect of each of the potential EMR/TO conflicts identified in the consultation:

- a. *Potential for increased network build*: the consultation footnotes the point that the incentive regime could “in theory” incentivise the TO to avoid transmission build: this is not theoretical. Under historic price controls there may have been a perception that NGET would benefit from investment (although in practice this was mitigated by the real risk of disallowance) but under the prospective price control set through RIIO the TO is incentivized to minimize investment since (assuming outputs are delivered) the TO will benefit by approximately 50% of the avoided investment. Consumers benefit by the other approximate 50%. So the theoretical risk that influence might be used to skew decisions in favour of network build and so advantage the TO is not a practical reality. In line with Ofgem’s principal duty to protect the interests of consumers NGET’s incentive not to build is aligned with consumer interests;
- b. *Artificial efficiencies could be disguised as real efficiencies* by allowing cost base of activities to be reduced: even if this were a practical reality (which we doubt) consumers would receive about 50% of any benefit realized;
- c. *Decisions in favour of onshore build* would benefit TO: This is not supported by evidence: if parties connect offshore or on distribution networks NGET will still have to provide bulk transport to the place of demand, so, for instance, 99MW embedded in a GSP in the north will lead to the same flows on the transmission system as if directly connected at the local GSP. NGET’s investments are scrutinized by Ofgem to ensure that all costs are efficiently incurred. If they are not, the cost is disallowed and borne by National Grid’s shareholders;
- d. *Certain technologies might offer better opportunities for TO profit* eg larger plant connecting to transmission rather than distribution networks: *this is also unlikely for 3 reasons*:
 - I. Whether the generation is embedded or transmission connected will frequently make little difference to transmission flows and hence the possible need for reinforcement of the transmission system. An embedded wind farm in the north of England will increase flows south on the transmission system to the same extent as the same sized transmission connected project⁸. It may actually trigger more investment because of the need to reinforce the interface between the DNO and NGET system; T
 - II. The connection works themselves are contestable so NGET would have no guarantee of winning the contract;
 - III. The general incentive on NGET to find ways to reduce investment means that it has no incentive to invest unnecessarily;
- e. *Favouring generation over DSR*: NGET’s existing charging rules for demand customers are cost reflective and so they already provide incentives for customers to reduce their demand at times when the system is being heavily used. This helps to reduce peak demands and hence the need for investment that would not be used at other normal / low demand periods;

⁸ There may be a small difference due to differing system losses but this is very much a second order effect.

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- f. *Over estimation of capacity requirements* could benefit gas transmission and storage: the incentives under RIIO do not encourage the building of additional gas transmission capacity so this is not a real risk. In addition, higher demand for gas would only occur if new gas generation actually generated, which, if it were built as a result of an over estimation it would presumably not. In respect of National Grid's gas "storage" business, this consists of one small LNG facility at Avonmouth which is in the process of being run down and closed (it is scheduled to cease operation in 2018). Given Avonmouth's size and limited life compared to the timescales for EMR it is difficult to see how there can be any material conflict. National Grid has no interest in any other storage facility.
- g. *More weight to intermittent technologies* to increase use of gas network: on the assumption that the flexible back-up plant to cover non-running intermittent plant will be gas-fired, we agree that an energy mix that includes more intermittent technology could lead to the need for investment on both gas and electricity transmission networks. More back-up gas plant may require additional gas network for flows and flexibility, and, if the location of the back-up gas plant differs from the intermittent plant it is covering then this implies that additional transmission infrastructure will be required in order to connect both sets of plant in a manner that avoids constraints arising that could limit the effectiveness of the back-up plant. However, the general disincentive to invest under RIIO should ensure that NGET⁹ has no incentive to favour more intermittent technology. We would note in addition that intermittent technologies are a fundamental part of the low carbon mix: this may lead to gas being used as baseload generation but that would be the case whoever was advising on the parameters.
- h. *Temptation not to challenge developers' assessment of cost of capital* – the consultation responds to this – the cost of capital for generators is not used as a basis for cost of capital for network operators. There are sufficient other comparators that Ofgem can draw on and Ofgem is best placed to protect the interests of consumers in this regard.
- i. *Undue weight to specific technologies* – 3 quite different NG businesses are cited – CCS, interconnectors and offshore wind: it is difficult to see how National Grid could skew its analysis in such a way that all of these were benefited. Such action would in any case be in breach of Special Condition C1 of NGET's Licence¹⁰, and it is arguable that it would also be in breach of competition law. It is not in National Grid's interests to act in a way that places NGET's licence at risk. However, we strongly support development of an open and transparent process and scrutiny by the Panel of Technical Experts under which any attempt by National Grid to discriminate in this way would very quickly be discovered.

⁹ National Grid Gas is similarly disincentivised from investment

¹⁰ See Annex 2

Annex 8

High Level SO/TO Synergies

- Whilst the SO is responsible for identifying network requirements and the TO is then responsible for designing and delivering suitable solutions to provide the network capacity/performance required, there are frequently advantages in the SO and TO working together to identify the optimum mix of operation measures (eg ancillary service contracts or intertrips) and network investment. Separation of the SO and TO would impede such collaborative working due to a changed contractual relationship and licence obligations. For instance, the obligation to meet the Great Britain Security and Quality of Supply Standard (GBSQSS) would continue to sit with the TO who might seek solutions that deliver TO licence obligations without reference to SO contracts to which they are not party, have had no role in developing and have no control over;
- TO input is required into modelling energy scenarios used for system development;
- From a customer perspective it is helpful that there is a single point of contact for customers for all matters related to accessing the energy market;
- Minimising duplication of work (eg pre-qualification process for CM is likely to include collecting information currently collected by the TO when designing and building a new generator's connection.