



Electricity System Framework
Ofgem
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Future arrangements for the electricity system operator: its role and structure

EDF Energy is one of the UK's largest energy companies with activities throughout the energy chain. Our interests include nuclear, coal and gas-fired electricity generation, renewables, and energy supply to end users. We have over five million electricity and gas customer accounts in the UK, including residential and business users.

EDF Energy supports the greater separation of the National Grid SO function within the National Grid Group. The proposals are a pragmatic response to the challenges the industry faces with the need to maintain continuity in this critical role while addressing perceived conflicts of interest.

It is important to recognise that there are increasing challenges for grid operation as the electricity sector shifts to a decarbonised generation mix, along with increases in intermittent and decentralised generation. This points to the need to carefully evolve the role of the System Operator including interactions with distribution networks. We consider that this is the start of the discussion around the role of the SO and the exact role and structure may need to evolve further with time and it is important that there is further debate with the industry about how the role of the SO needs to evolve.

The proposed pathway enables the SO to steadily become more independent in a fairly short timescale without diverting management resources from the task at hand of reliable and secure operation of the electricity system as the sector decarbonises. We agree that it makes sense to keep the option for establishing a totally independent SO open for future consideration.

Overall we believe that the proposed steps and changes look appropriate and provide further detail below. One area that greater clarity is needed is around accountability and control. As we understand the proposals National Grid group will wholly own NGSO and as sole shareholder will be exposed to gains and losses made by this company. However, there is no detail around the intended control and accountability that National Grid group will be afforded except for limitations on board structures and staff incentives. It will be important to clarify this point to better understand the degree of autonomy of NGSO and ensure NGSO continues to perform strongly in operating the system reliably and efficiently.

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Our detailed responses are set out in the attachment to this letter. Should you wish to discuss any of the issues raised in our response or have any queries, please contact Mark Cox on 01452 658415, or me.

I confirm that this letter and its attachment may be published on Ofgem's website.

Yours sincerely,

A handwritten signature in black ink that reads "Angela Hepworth".

Angela Hepworth
Corporate Policy and Regulation Director

Attachment

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EDF Energy's response to your questions

Chapter: Two

Q1. What are your views on our proposed objectives for the SO (set out in paragraph 2.1)?

We agree that the SO should be overseeing a safe, resilient, and cost-effective electricity system and driving competition and efficiency across all aspects of the system. While we agree that the SO should also be promoting innovation and flexibility, the SO should be technology neutral and should not have an explicit objective to promote any particular technology solution. We appreciate that it may be necessary to make changes to industry codes or to the CM Rules to keep pace with technological change in the sector and we strongly support the SO having a leading role in the framework development. However, this is different from having an explicit objective to promote, for instance, smart/demand side solutions and the difference in nuance should be captured in Ofgem's final decision.

The SO also provides advice to Government, for instance, parameters for the Capacity Market. Arguably, this advice and analysis falls within the proposed objectives but nevertheless it may be appropriate to capture this important function and be clear on expectations. Alongside this Ofgem may wish to consider National Grid's role in developing the Future Energy Scenarios (FES) and again be clear on expectations of the NGSO's role including setting out the implications for transmission system, operability issues, costs and whole system implications to help inform the industry.

Finally, we note that the SO is responsible for administering key parts of the CM and the allocation of CfDs and also provides an administrative function for a number of industry codes. These roles are important in themselves and appear to be beyond the current objectives and roles set out. It is important that NGSO is appropriately funded to deliver these roles well and may be worthy of being identified as a discrete area given the nature and scope of the role. Creating a discrete area might also make developing a specific incentive targeting this function easier.

Q2. What are your views on our expectations for how the SO should seek to achieve these objectives?

The four areas (i.e. acting as the residual balancer; facilitating competitive markets; facilitating a whole system view; and facilitating competition in networks) are key roles of the SO and we broadly agree with Ofgem's expectations for how the SO should seek to achieve the proposed objectives. We would also note that we would expect the SO already to be fulfilling many of expectations outlined. We also agree that there may be a

valuable role for greater stakeholder engagement in helping to shape and evolve SO targets, particularly with the system is evolving, and assessing whether the expectations are achieved as part of the SO regulatory framework and incentives.

The recent call for evidence on Smart, Flexible Energy Systems examined the roles of different parties in the energy system. The system is changing materially with a more decarbonised generation mix, increasing amounts of intermittent generation and significant increases in decentralised technologies. This brings new challenges for grid operation and it is clear that the role of the System Operator will need to evolve. Therefore, we see these proposals as the start of an evolution of the SO role and as further changes occur on the system, with potentially material changes at distribution level affecting further the SO's role and function, there should be further debate with industry about the role of the SO.

Q3. Do you agree with our proposals for what licence changes are needed to support these objectives?

Consequential changes may be necessary in order to recognise the existence of NGSO as the new SO and NGET as a TO. But we agree with Ofgem that the SO should be able to perform many of the identified objectives ahead of the proposed legal separation date, and we would welcome early action from the SO.

Q4. What are your views on the extent to which we should set specific or general obligations for the SO?

We think that a combination of both specific and general obligations supported by Ofgem guidance will be needed.

A general obligation supported by Ofgem guidance could give the SO flexibility and the opportunity to develop innovative solutions to new issues while specific obligations are more appropriate where the output or issue is well defined.

Chapter: Three

Q1. Do you agree that greater separation between NG's SO functions and the rest of the group is needed?

Yes, we support BEIS, Ofgem and National Grid's joint Statement announcing the greater separation of the SO functions from the rest of the group. The proposals are pragmatic and should help to alleviate the perceived conflict of interest concerns raised by industry in the past. We have previously noted potential conflicts of interest between National Grid's electricity interconnectors business, for instance, and the role of the System Operator. Further separation of NGSO from the interconnectors business is a step in the right direction in addressing these concerns.

The proposals also ensure that the level of disturbance to the SO function during the transition to a low carbon electricity sector is kept to a proportionate level and enables some level of continuity. It also enables the role to be kept under review and further change to be considered as the system evolves and the role of the SO develops. We also agree that the option to move to an Independent System Operator should not be closed and the additional separation measures discussed in the next question should be developed with this in mind.

Q2. What are your views on the additional separation measures we are proposing?

In terms of information separation, pragmatic steps should be taken in the shorter term to increase ring-fencing between the SO and TO. When a new system is developed in the future, we think it would make more sense if this is developed separately from other National Grid systems. Similarly, there is a debate to have whether the SO should be able to access National Grid's intranet sites. Since the SO will not have access other TO's intranet sites, arguably, it should not have access to those sites either.

One area that greater clarity is needed is around accountability and control. As we understand the proposals National Grid group will wholly own NGSO and as sole shareholder will be exposed to gains and losses made by this company in addition to providing financial support through RIIO T1. However, there is no detail around the intended control and accountability that National Grid Group will be afforded except for limitations on board structures. It will be important to clarify this point to better understand the degree of autonomy of NGSO and ensure NGSO continues to perform strongly in operating the system reliably and efficiently.

Finally, one area we think should be considered further is the creation of a separate brand. This is something that should be fairly easy to do and could create significant benefits. A different brand could help change the existing mind-set and help develop a new culture and identity for the SO. Having a different name from the National Grid Group of companies could also help external parties clearly identify where a specific view or recommendation is coming from i.e. is it a National Grid view or is the view from the SO.

Q3. What are your views on our proposed approach for implementing these changes?

We welcome the on-going industry engagement proposed by Ofgem and National Grid and acknowledge that this might result in some uncertainty in the timeline for delivering these changes. As and when decisions are made, we would welcome stakeholder events in addition to formal decision documents.

It also appears sensible to set the appropriate target date for separation of NGSO and NGTO at the start of a financial year due to the complexities involved in a mid-financial period implementation. The current target date of April 2019 is an ambitious but achievable target that we would support.

Chapter: Four

Q1. What are your thoughts on our proposed approach for implementing the proposed changes set out in this consultation?

We are broadly satisfied with the proposed approach for implementing the changes set out in the consultation. In particular, we welcome National Grid's intention to start taking steps to increase separation immediately and piloting new ways of working for the separate SO and TO functions in 2018.

Q2. What further evidence should we consider in finalising our impact assessment of the proposals on the SO's roles and level of independence?

We note that Ofgem has yet to review these costs but the initial National Grid cost estimate of an upfront cost of £46.5m and an on-going annual cost of £6.49m, resulting in a total cost of £166.87m appears excessive. It is important that NGSO is financially robust entity and has the resource it needs to undertake its key role but we would urge Ofgem to scrutinise the upfront costs in particular - given that we already have separate TOs in Scotland, we think many of the business change costs can be reduced substantially as the industry framework already is set up.

EDF Energy
February 2017