

Joint response to:

Future arrangements for the electricity system operator

– its role and structure and:

Future arrangements for the electricity System Operator: the regulatory and incentives framework

ENGIE, formerly known as GDF SUEZ, is a global energy company operating in three key sectors of power, natural gas and energy services. The company puts responsible growth at the heart of all its businesses in order to address major energy and environmental challenges: responding to the demand for energy, ensuring security of supply, combating climate change and making optimum use of resources.

ENGIE is present in 70 countries worldwide and has expertise in four key sectors: independent power generation, liquefied natural gas, renewable energy and energy efficiency services.

In the UK, ENGIE has interests in a number of activities across the energy value chain, from gas exploration and production through to services. In total, ENGIE employs approximately 17,000 people throughout the UK across all of its businesses. In generation, ENGIE is one of the country's largest independent power producers, with interests in 4,025 MW of plant. This comprises a mixed portfolio of generation assets that include gas, CHP, wind and the UK's foremost pumped storage facility. ENGIE also operates a major energy retail business supplying electricity and gas to the Industrial and Commercial sector, and is entering the domestic retail market in 2017.

ENGIE is also the UK's leading district energy company. We design, build, finance and operate district heating schemes on long term concession agreements. ENGIE's high profile district heating schemes include; the Queen Elizabeth II Olympic Park, Southampton District heating scheme, Whitehall District Heating scheme, Leicester District Heating Scheme and Birmingham District Heating Scheme.

Outside of energy, ENGIE is a leading services provider to the public and private sector in the UK, delivering a wide range of facilities management and back office services.

ENGIE welcomes the opportunity to respond to these two consultations. Whilst we have focussed on the role and structure consultation, the comments are also relevant to the regulatory and incentives framework consultation. In addition, ENGIE has already provided comments on the future regulatory framework in our response to the 2017/18 SO incentive scheme.

The role of the SO

Question 1- 4

What are your views on the proposed objectives for the SO?

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

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

Objective 1 – overseeing a safe, resilient and cost effective system.

1. ENGIE agrees with the first objective that the SO should oversee a safe, resilient and cost effective system. This should already be happening and does not require the creation of an independent SO. Ofgem wants the SO to consider ‘how its actions in the short term can impact the market and wholesale costs in the medium to longer term’. Whilst ENGIE supports the intent of this aim, disruptive technologies make it difficult for the SO to take a long term view on the costs of balancing. The swings in the prices seen in STOR tenders demonstrate this. To avoid being locked into high prices and also to be able to capture the cost savings of new technologies, ENGIE believes the SO should not be contracting more than 2 years ahead. It would however be helpful if the SO could provide an indication of the services that it will need in the longer term – the next stage of the System Operability Framework workstream could provide a basis for this.
2. We support the SO releasing as much information about the system and its actions as possible. Information on tendered contracts is available although it could be published in a format that is easier to understand with a more standardised layout between the different types of service. To allow market participants to make effective operational and investment decisions, ENGIE believes that SO website should be overhauled. Navigating the website is not intuitive – it is much easier to use a search engine to find information.
3. For services that are agreed bilaterally, such information must be limited to the general form of contracts rather than specific details such as prices. Since bilateral contracts are by their nature bespoke agreements, the pricing of the contracts will be commercially sensitive and should not be disclosed.
4. ENGIE agrees that better clarification of licence obligations would be of benefit. However, being highly prescriptive on the obligations is likely to be limiting to both the SO and Ofgem. ENGIE therefore supports principles based regulation largely replacing the current BSIS incentive scheme. As noted in ENGIE’s response to the 2017/18 incentive scheme consultation, the BSIS scheme has become extremely complicated and appears no longer fit for purpose. ENGIE does not consider it appropriate to continue with the scheme in its current form when the cause of model outperformance cannot be explained and it cannot be readily understood.
5. ENGIE does see a role for an incentive scheme but only in limited circumstances. This should be where the SO can control or influence costs. Where the SO has little or no control over the outcome incentivising behaviour is ineffectual. To give an example, the SO is currently incentivised to minimise transmission losses yet it has no control over the siting or self-dispatch of generation.

6. Similarly, it has no control over how BM participants price themselves into the Balancing Mechanism. Competitive markets ensure that balancing services will be delivered at lowest cost although it is for the SO to decide on how much of each service is needed across the varying timescales. Therefore, instead of incentivising on costs, the SO could set out its justification for procuring the volumes of different services. For all of these examples, principles based regulation could be applied.
7. If National Grid's role is to be extended, it will be important that any party can raise changes to all the market arrangements where National Grid participates. To give an example, only National Grid can raise changes to the C16 suite of documents. Market participants can only provide a view on National Grid's proposed changes, they cannot themselves raise changes in this area.
8. The Power Responsiveness forum has driven the development of service provision from new sources. In seeking greater accessibility for the provision of balancing services, this should not be pursued at the expense of the consumer. In facilitating competition it needs to be made clear that this should only happen where it is economic to do so and ensures equitable treatment between different types of provider.
9. One example where this inequity exists is in the provision of STOR. Currently, where STOR is provided outside of the BM, non BM provider can (via the supplier) receive a spill payment in addition to any utilisation payment made when the service is called. BM providers receive only the utilisation payment. The SO does not take account of the spill revenue when assessing tenders or when it dispatches non BM STOR. ENGIE has raised BSC modification P354 which removes the spill payment from the supplier to address this. Until this is implemented, the SO should have a clear obligation to consider overall costs of its balancing actions.
10. Aligned to this, there is a low level of transparency of the SO's balancing actions taken outside of the Balancing Mechanism. Whilst BM actions are visible to the market in real time, no information is available on the use and despatch of the demand /non-BM side of the market.
11. The SO has moved many services onto standard tendered terms and ENGIE supports this approach as it does increase transparency. ENGIE believes that these standard products should also include a requirement to provide delivery reports for all types of provision whether they be through the BM, non BM or through aggregators. This is a key opportunity to improve performance of all providers.
12. Some of the suggested transparency reports will address these concerns but these may need to be part of a further review of SO information provision including whether "self-certification" of the delivery of some services remains appropriate.
13. The joint BEIS/Ofgem flexibility call for evidence stated that the SO aims for 30-50% of balancing services capabilities to come from the demand side by 2020. The greatest opportunities and benefits should in theory come from revenue stacking 'behind the meter'. However there does seem to be a lack of interest from the DSR community to monetise this. Reasons cited (which ENGIE agrees with) are the lack of long duration contracts, onerous testing and metering requirements and lack of price signals in timescales to which DSR can respond. There have been calls for lighter touch regulation to address these concerns. ENGIE does not agree with this. Strong regulation is needed to ensure fairness and transparency - if derogations are allowed, this may impact on security of supply.

Objective 2 – driving competition across all aspects of the system

14. As a general principle, if the SO is to drive further competition then this should be through an entirely separate entity, not one where part of the business also owns transmission assets even where there is a more independent SO. Only with this can any conflicts of interest be removed.

Objective 3 – Promoting innovation, flexibility and smart/demand side solutions

15. In considering non build solutions as an alternative to network investment, neither the SO or TO part of NGET or DNOs should be allowed to own generation assets even if in the unregulated part of their business. Generation asset ownership by any network operator creates a conflict of interest (perceived or otherwise) where there are other owners of generation connected to that network. It places the network owners in an advantageous position compared to other providers in that they have an informational advantage in terms of network needs and it can stifle innovation in developing new technologies and competition. Allowing such activity may be the 'thin end of the wedge' to greater participation in the energy market.

16. ENGIE would welcome more detail on the licence changes that are proposed to support these objectives.

A more independent SO

Question 1- Do you agree that greater separation between NG's SO functions and the rest of the group is needed.

Question 2 – What are your views on the additional separating measures that we are proposing?

Question 3- What are your views on the proposed approach to implementing these changes?

17. The SO's role has expanded greatly from that of residual balancer. It is now the EMR Delivery Body, it delivers policy ambitions such as encouraging demand side participation, its transmission business continues to grow to allow the connection of renewables and it also owns a growing interconnector business – with these interconnectors taking part in the capacity mechanism which the SO operates. Within all of this, current conflicts of interest have to be managed.
18. As the system becomes more complex and the interconnector business grows, these conflicts of interest will also grow. To manage this there either needs to be a more robust set of mechanisms or a fully independent SO.
19. ENGIE welcomes the move to a 'more independent' SO but considers that a more robust set of mechanism to be difficult to manage - the need to always demonstrate fair play will be a distraction from the SO's main role as residual balancer. It will be many years (perhaps a decade) before it is understood whether the new arrangements work.
20. Rather than spend the estimated £46m to achieve a more independent System Operator and still have the potential for conflicts of interest, the simplest solution would be to move straight to a fully independent SO. The question Ofgem should be asking is whether the advantages of National Grid being the SO outweigh the structural conflicts of interest.
21. Other markets do operate with an ISO and will have to manage cashflow issues associated with under recovery. This should not be seen as a barrier to full separation.

22. Whilst ENGIE believes that a fully independent SO is the better option, if there is to be a more independent SO then the separation measures should apply to all functions that would ordinarily not be outsourced – i.e. those that the the SO would not wish to handover to an external company. This would mean that as well as employees that clearly work in an SO function, regulatory, legal, finance, corporate affairs, and internal audit functions would be needed for both the SO and the TO.

Next Steps

Question 1- What are your thoughts on our proposed approach for implementing the proposed changes set out in this consultation?

23. ENGIE agrees that where licence changes are not necessary (to deliver the first objective of overseeing a safe, resilient and cost effective system) and that work can commence now.

Question 2 – What further evidence should we consider in finalising our impact assessment of these proposals on the SOs roles and the level of independence?

24. If there is to be a more independent SO, as well as separate bonus arrangements, Ofgem will need to consider whether it is appropriate for employees on the SO side to be able to participate in the wider National Grid share save scheme and also whether the SO board and its senior management are entitled to National Grid share options. Allowing either of these will create conflicts of interest.
25. The culture that effectively two separate organisations are being created needs to be fostered starting now. As part of this, once the more independent SO, is created moving roles between the SO and TO functions should no longer be seamless. They should be regarded as two separate organisations with their own employment contracts and loss of any service continuity.

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