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Stathis Mokkalas – Electricity System Frameworks, Ofgem
David Beaumont – System Balancing, Ofgem

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BY EMAIL ONLY TO: electricitySOreform@ofgem.gov.uk

Dear Sirs

Consultation on Future Arrangements for the electricity SO

As part of the Transmission Capital Partners consortium, Transmission Investment manages one of the largest offshore electricity transmission portfolios in terms of the capacity of offshore wind connected. Our managed portfolio of Offshore Transmission Owner (OFTO) assets includes the connections to the Robin Rigg, Gunfleet Sands, Barrow, Ormonde, Lincs and Westermost Rough offshore wind farms - a portfolio of over 1000MW (circa £800m in capital employed).

Transmission Investment is leading, in partnership with the French national grid company RTE, the development of a proposed 1400MW HVDC interconnector between France and Britain via Alderney ("the FAB interconnector project"). This project was granted cap & floor regulatory treatment in 2015 and is scheduled to commence construction in the 2017-18 period.

Transmission Investment remains a strong advocate of introducing competition into the delivery of onshore transmission and we continue to support the development of the required arrangements *inter alia* through industry groups, responding to consultations and, when called upon, providing evidence to parliament. Independence of the SO is a necessary condition for this competition to be successful.

As requested we are providing a joint response to the two part consultation on the future arrangements for the electricity SO.

Role and structure

We very much welcome the consultation on the SO role and structure and are very supportive of the proposal to have legal separation of the SO from other NG entities. However, we do not think that the proposed separation measures go far enough to deal with conflicts of interest, perceived or otherwise, even if it is accepted that complete ownership separation is not achievable at this time.

We believe that for the SO to act independently, its employees should have no affiliations to the National Grid Group, and should consider themselves as SO

employees only. We have set out in Appendix 1 the measures we consider are necessary for this, in summary they include:

- The SO has different Email and website domain names from other NG entities;
- The SO has separate and distinct corporate branding from other NG entities;
- SO staff employment contracts to be with the SO legal entity;
- Strict enforcement of notice periods on transfers from SO to other NG entities
- The SO has its own separate HR department;
- There is no internal advertising of NG roles within the SO (and vice-versa);
- Separate pension arrangements (at least for new SO staff) so that SO staff are not incentivised to join another NG entity in order to retain pension entitlements;
- The SO has a geographically separate office location.

We also consider that this independence, if implemented correctly, should have some significant benefits in enabling the SO to fulfil its new role. For example, if SO employees, prior to joining the SO, are equally likely to have worked at a generator, flexibility services provider, DNO, OFTO, Scottish TO, or indeed any other industry participant, as another NG entity, then the SO will have a diverse set of employees that will understand the whole system and be well positioned to reduce the costs of the whole system over the long-term.

We attended the Ofgem hosted session on the SO at Church House, Westminster on 2nd March 2017. In respect of SO employees, it was stated by one of the National Grid representatives that it was important for the National Grid Group that they had the opportunity to rotate senior staff through the SO, so that the staff could gain valuable industry experience. It is exactly this sort of practice that would both provide an unfair advantage to other NG entities (no other competing TO or interconnector business has this opportunity); and would make the SO less independent (because at any one time some of its senior staff would know that their next role is back in another NG entity). This illustrates to us that National Grid hasn't really accepted the need for the SO to be independent and to be seen to be independent.

Whilst we remain strong advocates of ownership separation (ultimately we do not see any arguments against this other than difficulty in implementation) we accept that now may not be considered the right time to take that final step, given the background of change in the industry and the challenges it faces, and the wider political landscape. We do however suggest that work should commence in the near future on the pros and cons of taking the next step to full separation, and that going forward the SO should act in a way that makes complete ownership separation easier and not more difficult. One example of this would be that all new or replacement IT systems should be separate.

Our response to the detailed questions in this part of the consultation focuses on the need for the SO to support competition in networks and interconnectors, rather than its role in balancing or facilitating competitive markets for energy, capacity or ancillary services.

Our response to all the questions in this part of the consultation is attached as Annex 2.

Regulatory and Incentives Framework

We have read with interest this related consultation but we do not have at this time specific responses other than:

- i) Principles based regulation will make greater independence of the SO even more important;
- ii) There should be developed SO incentives on its role in facilitating competition in the delivery of onshore networks, particularly for the post RIIO-T1 period where it will play a greater role;
- iii) We consider that reputational incentives could be powerful on an independent SO, particularly through the use of benchmarking with ISOs or comparable organisations.

We should like to reiterate that we are supportive of the vast majority of the proposals made in the consultation and consider that when implemented they will deliver a significant step forward to creating the industry structure that is needed in the future.

If you would like to discuss any of the comments above please feel free to contact me.

Yours faithfully



Chris Veal
Managing Partner

Annex 1 – Employee separation

Whilst we agree that SO employees should only work on SO issues and TO employees should only work on TO issues we think the separation measures should be extended so that from an employee perspective the SO is seen to be an independent company. This runs to office location, support services, pension arrangements and staff transfers. In the absence of these employee separation measures an employee is going to consider himself/herself an employee of the NG Group and will be minded to act in the interest of the NG Group rather than the SO alone. Career development is a strong personal incentive on employees and if there is any chance that career development could be impacted by (quite correctly) not favouring other NG interests then conflicts of interest will still exist. SO employees should not see themselves as employees of the NG group but as employees of the SO. Their career path should be within the SO or outside of the SO more widely (rather than outside of the SO but within the NG Group).

Issue	Proposal and rationale
Culture and branding	It is important that each SO employee considers himself/herself to be acting for an independent SO that has no affiliations to other NG entities. In this respect the National Grid name and brand should not form part of the SO naming or branding. This should extend as far as Email and website domain names, and all other corporate branding used by the SO. We note that there are parallels here with Openreach no longer using the BT brand or logo.
Employment Contracts	SO staff employment contracts should be with the SO legal entity and not with any other National Grid legal entity. This is to ensure that employees regard themselves as employees of an independent SO and not as employees of National Grid more widely.
Notice periods on transfers of SO employees to another NG entity	There should be a strict enforcement of notice periods on transfers of an SO employee to any other NG entity, as indeed there would be with a transfer to any other industry participant. This is both necessary to ensure that "gardening leave" type provisions can be enacted to mitigate confidentiality issues, but also to ensure that other NG entities do not have access to SO employees on preferential terms compared to other industry participants.
Separate HR departments	There should be no shared HR services between the SO and other NG entities (we argue in Appendix 2 that this should extend to other shared services too). A shared HR service would be tantamount to other NG entities having their own recruitment consultant sitting inside the SO with access to employee records. The SO will be a substantial business in its own right and we do not believe that separate HR departments should give rise to any significant increase in costs.
Prohibition on internal advertising	There should also be a prohibition on internal advertising between the SO and any other NG entity

	<p>in respect of staff vacancies (and vice versa), and no liaison between their respective HR departments. Essentially the SO should appear as an independent entity as far as its staff are concerned.</p>
Pension arrangements	<p>The SO should have its own staff pension arrangements – at least for new staff if separation of pension arrangements for existing staff is too difficult. In the absence of this, pension arrangements could incentivize SO staff to be more likely to work for other NG entities, which may impinge on the way the employee thinks, and thereby advantage these NG entities unfairly.</p>
Separate office location	<p>The SO office – this should be on a separate site from other NG entities – separate facilities within the same site (whether in the same building or not) should be for a limited period only. This would both limit the scope for confidential information to pass from SO employees to staff of other NG entities, and also reduce the chance that another NG entity is the <i>de facto</i> next job of an SO employee.</p> <p>Clearly the greater the distance the better but 5 miles or more would at least mean it was perceived as a different location even if employees did not need to move house to move jobs (as they may well have to work for another industry participant).</p>

Annex 2 – Its Role and Structure

Chapter: Two	
<p>Question 1: What are your views on our proposed objectives for the SO (set out in paragraph 2.1)?</p>	<p>We agree that the SO should oversee a safe resilient and cost effective electricity system and that in doing this it should take a whole system approach, that it should drive competition and efficiency and promote innovation, flexibility and demand side solutions as well as conventional generation and interconnector solutions.</p> <p>As part of this we consider that the SO could have a greater role in planning the system (taking a whole systems approach). In fact we would consider that the SO should have the role of planning all works necessary to connect new generation or demand, and in generally ensuring that the NETS complies with the SQSS. Allowing the TOs to continue in this role is a conflict of interest in itself as they will be incentivised to ensure that schemes do not meet the criteria for competition irrespective of whether they are the best solutions.</p>
<p>Question 2: What are your views on our expectations for how the SO should seek to achieve these objectives?</p>	<p>[No response]</p>
<p>Question 3: Do you agree with our proposals for what licence changes are needed to support these objectives?</p>	<p>[No response]</p>
<p>Question 4: What are your views on the extent to which we should set specific or general obligations for the SO?</p>	<p>[No response]</p>
Chapter: Three	
<p>Question 1: Do you agree that greater separation between NG’s SO functions and the rest of the group is needed?</p>	<p>Yes – there are increasing conflicts of interest in having the SO as part of the National Grid group, that have developed over recent years.</p>
<p>Question 2: What are your views on the additional separation measures we are proposing?</p>	<p>We consider that the proposals do not go far enough and that a cleaner and fuller separation between the SO and the rest of the NG Group could be achieved at relatively little cost but with the benefit of being seen to be dealing with the potential conflicts of interest in a more transparent, effective and robust way.</p> <p>Our proposals in respect of SO employees are detailed in Appendix 1. Essentially to an SO</p>

	<p>employee, the SO should appear as though it is a fully independent business from the NG Group.</p> <p>In respect of the detailed implementation of other aspects:</p> <p>Governance of the SO – we agree that separate SO and TO boards are required but we would go further than saying that no SO board members should sit on the boards of any other NG electricity company or the NG Group board to a complete prohibition on any SO board member being a board member of any other NG company.</p> <p>Financial Separation and Credit worthiness of the SO – we agree with financial separation but we consider that Ofgem should ensure that arrangements put in place for the independent SO (minimum credit rating requirement and PCG) do not lead to credit rating agencies viewing the SO as a less credit worthy counterparty than the existing NGET. If this were not the case than it may, for example, lead to increase costs to consumers due to higher debt costs for entities who receive their revenue via the SO.</p> <p>Shared Services – we see no need for any shared services between the SO and other NG entities. The SO will be a substantial business in its own right and therefore we do not consider that there would be any significant costs of support services being provided separately for the SO and other NG entities.</p> <p>Regulation in particular is a key area where it is not possible for a joint regulatory department to represent the SO and TO without conflicts of interest arising. Other industry participants needs to have their own regulatory expertise and so we do see that the rest of the NG Group should be able to build on the resources partially funded by the SO.</p> <p>Information and IT system ring-fencing – there should be a requirement for full system separation of IT systems within a defined period of time (particularly on all new or replacement systems) so as to reduce the costs of eventual full ownership separation of the SO if that is eventually mandated.</p>
<p>Question 3: What are your views on our proposed approach for implementing these changes?</p>	<p>The implementation approach appears to require National Grid to apply for the licence separation, which it will presumably only do if it considers the outcome acceptable.</p> <p>The approach therefore appears to be a negotiated approach – i.e. one that National Grid is prepared to accept, rather than one imposed upon National Grid. As such the approach ties Ofgem/the government hands on</p>

	<p>the separation measures it can achieve.</p> <p>There is no detail in the consultation document on any separation measures that have been proposed by Ofgem and not agreed and so it is not clear whether some or all of our suggestions in our response to Chapter 3 Question 2 above could be achieved by negotiation.</p> <p>The alternative of imposition presumably requires primary legislation.</p> <p>Whilst the negotiated approach may be the most pragmatic approach in the short-term we understand that Ofgem/the government has given no undertakings that full ownership separation may not be required (imposed) at a later date (cf para 3.9 of the consultation document).</p> <p>In summary whether we agree with the approach depends on the degree of separation achieved (in particular those additional measures set out in Appendix 1).</p>
<p>Chapter: Four</p>	
<p>Question 1: What are your thoughts on our proposed approach for implementing the proposed changes set out in this consultation?</p>	<p>We generally agree with the timetable being proposed including progressing implementation of the separation measures before full legal separation takes place from 1 April 2019.</p>
<p>Question 2: What further evidence should we consider in finalising our impact assessment of the proposals on the SO's roles and level of independence?</p>	<p>Whilst the costs of greater separation are relatively easy to quantify (although the NG cost estimates do seem extraordinarily high) the benefits are less easy to quantify.</p> <p>We note that the impact assessment only lists the "<i>Do nothing</i>" option as an alternative option considered. This implies that greater separation was not considered – whilst this seems unlikely we would argue that Ofgem/the government should consider the impact of the greater separation measures outlined in Appendix 1 to this response.</p> <p>This consultation process should highlight whether industry participants are generally in favour of the proposals made or whether there is a significant view that they do not go far enough. If the latter is in fact the case we would suggest that Ofgem/the government consults again on stronger separation proposals or indeed if the evidence is already strong and consistent enough through the consultation responses, implements stronger separation measures (with or without National Grid's agreement).</p>

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