



Ofgem Consultation

Future arrangements for the electricity system operator: its role and structure

Response by E.ON

Chapter 2: The role of the SO

Question 1: *What are your views on our proposed objectives for the SO (set out in paragraph 2.1)?*

1. E.ON agrees with the objectives set out for the SO. Clearly, delivering a safe, resilient and cost-effective electricity system is a key function of the SO in order to deliver value for customers and E.ON believes that in the future a more holistic approach to this will be necessary as described. Similarly, value to customers will be maximised by ensuring that this is delivered through competition and efficient approaches. Promoting innovation and flexible solutions will require reform of network charging, reform of balancing and ancillary markets and a clear and consistent regulatory approach to ensure that these truly provide a level playing field for any participants.
2. E.ON believes that, given the scope of change that is required to deliver such a future system, it will be important for the SO to have a consideration of the degree of complexity that this may create and the potential barriers that could occur as a result. A clear objective to consider the complexity of approaches and whether simpler approaches may bring greater benefits would be helpful. This would allow the SO to use simpler solutions which drove efficiency and cost reductions through competition rather than through the most theoretically efficient design that reduced competition due to complexity.

Question 2: *What are your views on our expectations for how the SO should seek to achieve these objectives?*

3. E.ON agrees that the SO must maintain a role as residual balancer and that a more holistic and longer term view would be more efficient and deliver greater benefits to customers. Increasing transparency will allow clear market signals to help market participants balance their own positions but will also allow the SO to identify the gaps where they need to take greater action to procure balancing services.
4. E.ON believes that the SO, working with market participants, needs to move towards a much simpler, transparent, market based and competitive framework for balancing services, ensuring a level playing field for all technologies. It is important that transparency is increased not just in what the services are, but also how they are procured. Market-based approaches provide more effective signals to participants than directly negotiated bilateral contracts and the SO should move towards these wherever possible. The forthcoming European Guidelines on Electricity Balancing are also expected to require this as well.
5. The benefits this could bring to customers in terms of increased market participation, increased price signal certainty to drive down risk and allow new innovative solutions would be significant. Such services need to be designed for both current and future technologies (such as energy



storage, demand side response and EVs) rather than fit for only existing technologies. The design should not be based upon what current technologies are able to do, but rather what the network and system requires. This approach, combined with clear price signals, would allow providers to tailor their solutions to deliver a more efficient system. Alongside this, it is very important that services are designed in such a way to allow providers access to multiple value streams where possible. This is a key criterion for attracting investment into this market as it helps provide greater revenue certainty on which to build an investment case.

6. Ensuring that the SO's incentives allowed it to maximise efficiency of the whole electricity system and optimise for new technologies and systems rather than just current systems will be vital to ensure that customers obtain the greatest overall benefit. This means that the SO incentive schemes need to allow for trade-offs between operational and investment costs and should be based upon a long-term view as well as short-term objectives. It is also important that this incentive scheme is transparent to market participants to allow them to better understand the drivers behind the SO's decisions and to allow appropriate challenge to those decisions.
7. E.ON agrees that strong collaboration between the SO and DNOs will be necessary going forward as DNOs start to take on greater DSO roles. This needs to be a smooth transition with strong coordination and the SO is well placed to facilitate this. It is important that this transition does not cause the operation of the system to fragment as each DSO seeks its own separate solutions to similar problems but rather that a harmonised approach across the whole system is adopted allowing market participants to interact on a consistent basis across multiple DSOs and the SO.
8. E.ON believes that the SO will continue to be well placed to have an active role in industry codes. However, we believe that it could go further by ensuring that future needs of the system are considered when code modifications are being proposed, discussed and assessed. Whilst the CMA reforms to code governance will ensure a strategic direction is in place and considered, active participation by the SO, with its broad market knowledge, will be key. In addition, many of the modifications require analysis to support decisions and the SO could take a stronger role in supporting this by providing greater transparency.
9. With regards to its role as the EMR delivery body, E.ON agrees that the SO should continue to seek to improve its forecasts and methodologies. However, it is important that these are not only driven independently from the TO, but also from other external influences such as political drivers. Any skewing of outcomes will lead to inefficient results which, given the importance of security of supply, could have significant impacts. For example, it is important that such forecasts are not used to dilute the technology neutral nature of the capacity mechanism.

Question 3: *Do you agree with our proposals for what licence changes are needed to support these objectives?*

10. E.ON agrees that many of the proposals discussed for the role of the SO can be achieved without change to licence obligations. Where changes are necessary, E.ON believes that clear principles that can be understood by all market participants are likely to deliver a better outcome than overly prescriptive changes.



Chapter 3: 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?*

11. E.ON recognises that there are a numbers of areas in which the SO has a conflict of interest such as assumptions around interconnectors and its role working with the TO and DNOs as residual balancer where it can have a choice between advocating network investment or market services. We believe that the current licence obligations and processes that are in place are sufficient to ensure that these are not an issue. Therefore, we do not necessarily see a strong need for greater separation between NG's SO functions and the rest of the group. However, we are aware that others in the industry and within Government also perceive there to be an issue and hence E.ON understands that it may be beneficial to take steps to alleviate this perception.

Question 2: *What are your views on the additional separation measures we are proposing?*

12. E.ON believes that it is important that the costs of greater separation are outweighed by the benefits. The consultation sets out draft costs provided by NG and E.ON expects these to be appropriately challenged given their magnitude. The difficulty is likely to be a reliable assessment of the benefits as they are much less tangible given that they are driven by the removal of a perception of behaviour. E.ON would ask that any decision needs to be robustly justified to ensure that customers receive value from the decision.
13. Should such an analysis result in a clear need for separation, it is not clear to E.ON that the current proposals for separation go far enough to address the proposed issue. Continuing to share the same office, albeit separated, and having overlapping shared services and support functions (e.g. the regulation function) could allow the perceptions of conflicts of interest to remain. E.ON would suggest that in such circumstances, complete separation and the creation of a fully independent SO would be likely to achieve a better outcome. It therefore would make sense to assess the option of complete separation alongside the impact assessment of the current proposals to ascertain the presumably additional costs that this would incur and the degree to which both options solve the perception of the issue of conflicts of interest.

Question 3: *What are your views on our proposed approach for implementing these changes?*

Chapter 4 Next: Steps

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

14. We note the target date of April 2019 for the separation of NGSO and NGTO if this proposal is to be taken forward. Firstly it seems sensible to implement any change to coincide with the start of a financial year. However, as the consultation accepts, there are a number of processes that will need to be undertaken to deliver separation including licence changes, asset transfers code and contract changes. What is most important is to ensure that this happens in the most effective way, and that the driver is not to hit an arbitrary date. The impact assessment must rigorously test the proposed timeline before setting the final date.



Question 2: *What further evidence should we consider in finalising our impact assessment of these proposals on the SO's roles and level of independence?*

15. E.ON suggests that it would be sensible to assess the option of complete separation alongside the impact assessment of the current proposals to ascertain the costs that this would incur and the degree to which both options solve the perception of the issue of conflicts of interest.