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Friday 10th March 2017

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

Dear Stathis,

RWE welcomes the opportunity to respond to the Ofgem consultation on the “*Future arrangements for the electricity system operator: its role and structure*” (the Consultation Document) published on 21th January 2017. We are responding on behalf of RWE Supply and Trading GmbH and RWE Generation plc. This is a non-confidential response.

We support Ofgem’s intent to introduce further separation between National Grid’s electricity System Operator (SO) and electricity Transmission Owner (TO) functions. We believe that such separation is in the long term interest of consumers and removes the potential for conflicts of interest that may otherwise arise.

It is important that measures are put in place to ensure effective and efficient business separation within National Grid. This includes, for example, full separation of the respective activities rather than cosmetic separation with for example continued sharing of buildings and services. Without effective separation of SO activities from TO activities, there is an inherent risk of discrimination not only in the operation of the network but also in the incentives for the England and Wales TO (E&WTO) to invest efficiently in its network.

Fully effective separation of the SO from the TOs should apply throughout GB. This will ensure that the GBSO and GBTOS remain independent from each other. Ofgem should be empowered to ensure that the GBSO and the relevant TOs comply fully with unbundling rules on a non-discriminatory basis.

We are concerned about the initial cost estimates associated with the separation of the GBSO from the E&WTO activities presented in the consultation document. Given that the SO and E&WTO activities are currently separately defined within the electricity transmission licence, we would expect that the one off and enduring costs of legal separation should be relatively trivial. Indeed, we note that there is already functional

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separation between the GBSO and the Scottish TOs and OFTOS, and we would expect that these arrangements would apply to the GBSO and the E&WTO.

We do not support the intention to retain GBSO functions within the head office of National Grid in Warwick. We would expect that the GBSO would operate as a stand-alone business in a manner that ensures effective separation of GBSO and E&WTO activities. This would reflect the fact that the GBSO is legally and functionally separate and independent from the E&WTO.

Our response to the specific question in the consultation document is included in Annex 1. If you have any comments or wish to discuss the issues raised in this letter then please do not hesitate to contact me.

Yours faithfully

By email

Bill Reed
Market Development Manager.

Annex 1: Response to the specific questions in the consultation document

Chapter: Two

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

We welcome the definition of key objectives for system operation in GB. These should be included in a relevant licence condition. With regard to the details we support an overall objective for the GBSO to operate a safe, resilient and cost effective electricity system.

We have some concerns about the GBSO “*driving competition across all aspects of the system*”¹. Rather we believe that the SO should facilitate competition in relation to the provision of transmission assets and wider competition in the electricity market.

It is not the role of the GBSO to “*promote*”² innovation, flexibility and smart/demand side solutions. While innovation and flexibility are important attributes of system operation this should be enshrined in general economic and efficiency objectives. In this context we believe it is important that the charging regime is cost reflective, results in appropriate market signals, is non-discriminatory and implemented in a manner that does not distort the electricity and capacity markets.

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

We support the Ofgem vision with regard to the evolution of the GBSO role to facilitate and respond to the transforming electricity system. In particular we welcome greater transparency and improvements to the way that the GBSO procures balancing services in its role as residual balancer. The GBSO can better facilitate change in the electricity markets by acting as an impartial administrator of wider market arrangements (particularly in relation to codes, capacity markets, and electricity charging). It is essential that the GBSO has appropriate incentives to deliver economic and efficient non-discriminatory and cost reflective outcomes.

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

It is essential that the GBSO functions are clearly differentiated from the E&WTO functions in appropriate licencing arrangements. We believe that the GBSO function should be in a separate licence from the TO licence. In this context National Grid should establish a separate company to fulfil the GBSO role. This company could be established in manner that resembles BSCCo (Elexon) in order to establish and preserve the independence of the GBSO.

We are concerned about the costs estimates submitted by National Grid in relation to performing the GBSO role. We believe that these costs should be relatively low since in theory National Grid already performs the GBSO role in a way that should independent of its E&WTO role (this is already the case with respect to the Scottish TOs). In this context independent directors and a separate GBSO Board are prerequisites for performing the independent GBSO role.

¹ Consultation Document, Paragraph 2.1, bullet 2, page 11

² Consultation Document, Paragraph 2.1, bullet 3, page 11

Question 4: What are your views on the extent to which we should set specific or general obligations for the SO?

We believe that specific obligations in relation to GB system operation should be established within the GBSO licence. These obligations should include a specification of the roles and responsibilities of the GBSO, its duties under its licence and wider objectives for delivering economic and efficient system operation, facilitating competition, and ensuring that system operation does not distort electricity and capacity markets. Essentially the licence conditions establish the regulatory arrangements between Ofgem and the service provider and form the basis for principles based regulation. The licence condition must also establish the relationship between the GBSO and the principal actors in the electricity and capacity markets.

Chapter: Three

Question 1: Do you agree that greater separation between NG's GBSO functions and the rest of the group is needed?

We agree that greater separation between NG's GBSO function and the rest of the group is needed. The proposed business separation will reduce (though not remove) the potential for conflicts of interest between the NG GBSO and NG TO activities.

However, we would go further than Ofgem purpose and seek full separation of the GBSO and TO and introduce arrangements that resemble the GBSO/TO relationships in Scotland. Enhanced separation and formal arrangements between the GBSO and TO would remove the potential for the TO to influence the GBSO. In this context we would support the creation of a separate company under NG ownership with operations conducted fully independently from the TO activities. To achieve this the GBSO should be operated and located separately from the E&W TO.

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

The additional separation proposed is a welcome first step in relation to the creation of a GBSO. However, they do not go far enough and further work is required to establish a fully independent GB GBSO.

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

Separation of the GBSO from the England and Wales TO should take place as soon as practicable.

Chapter: Four

Question1: What are your thoughts on our proposed approach for implementing the proposed changes set out in this consultation?

As noted above we support implementation of the business separation as soon as practicable. However, we believe that full separation of the GBSO from the E&WTO should take place at least in time for the RIIO review process. Therefore a fully independent GBSO should be in place from 1st April 2021.

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?

Ofgem should scrutinise NG's for business separation carefully and challenge vigorously the assumptions that have been made by NG regarding the potential costs of the change.