

Energy UK,  
Charles House  
5-11 Regent Street  
SW1Y 4LR

17 March 2017

Dear Stathius,

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

We welcome the opportunity to respond to this consultation. Energy UK is the trade association for the GB energy industry with a membership of over 90 suppliers, generators, and stakeholders with a business interest in the production and supply of electricity and gas for domestic and business consumers. Our membership encompasses the truly diverse nature of the UK's energy industry – from established FTSE 100 companies right through to new, growing suppliers and generators, which now make up over half of our membership.

Our members turn renewable energy sources as well as nuclear, gas and coal into electricity for over 26 million homes and every business in Britain. Over 619,000 people in every corner of the country rely on the sector for their jobs, with many of our members providing lifelong employment as well as quality apprenticeships and training for those starting their careers. The energy industry adds £83bn to the British economy, equivalent to 5% of GDP, and pays over £6bn in tax annually to HMT.

**Executive Summary**

Energy UK members are generally supportive of the consultation and the decision to further separate the System Operator (SO) from the Transmission Owner (TO).

However, Energy UK believes that in some ways it is difficult to provide a well-informed view on what the roles and structure should be of the GBSO<sup>1</sup> when there has been so little guidance and information provided on the role of the 'Distribution System Operator' (DSO). The relationship between DSOs and the GBSO is fundamental and yet the Transmission Distribution interface was hardly mentioned in the consultation document. Having said that, Energy UK has answered and, on the whole, is supportive of the suggested changes.

Members of Energy UK see this as an opportunity for the GBSO to create a new identity, embrace competition and transparency as governing principles. We appreciate that steps have been taken to make processes more transparent, but this change presents the GBSO with the perfect opportunity to move to a completely transparent, open and effective GBSO. Physical separation, the recruitment process for GBSO staff and a new identity should help to achieve this.

In the current industry context and considering the challenges faced we believe the proposals for a legally separate SO is the right solution and can further mitigate conflicts of interest associated with the current structure. As noted, this approach does not preclude the future move to an ISO if the case is proven that this will deliver consumer value proportionate to the additional costs to industry and consumers.

In the spirit of the separation of GBSO the TO, any future new IT systems deployed in any future should be consistent with the principles of the legal separation of the System Operator.

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<sup>1</sup> DTI/Ofgem invited submissions for the role of System Operator for Great Britain (GBSO) in August 2002. In September 2002 it was announced that National Grid had applied to be the GBSO. On 17<sup>th</sup> December 2002, the Minister of State for Energy and Construction announced that the appointment panel had recommended the appointment of National Grid to the role of GBSO.

Finally, Energy UK would like Ofgem to scrutinise the costs in the proposed costs outlined in Appendix 2. Some members have had experience with business separation, and while we agree there is a cost to business separation, Ofgem should look to scrutinise some of the estimations. This is especially the case here, where National Grid currently perform both tasks (SO and TO) and these tasks will continue, all be it in two legally separate companies. When costs are decided, and applied, is important that industry has advance warning and visibility of what the costs are and when they will be applied.

If you have any questions, please do not hesitate to get in touch. Energy UK is happy to facilitate discussion with members to talk through this response.

Kate Dooley  
Policy Manager

T 020 7747 2942 W [www.energy-uk.org.uk](http://www.energy-uk.org.uk) t [@energyukcomms](https://twitter.com/energyukcomms)  
Energy UK Charles House, 5-11 Regent Street, London SW1Y 4LR

# Energy UK response to Future arrangements for the electricity system operator: its role and structure

March 2017

## Chapter Two

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

By and large, Energy UK supports the objectives that are outlined in paragraph 2.1 of the consultation.

In deciding how to ensure, operationally, that the system is safe and resilient, the GBSO should embed competition as a governing principle. In order to ensure that this is cost-effective; for example, when procuring black start capability, the GBSO should ensure that competition is considered.

Energy UK sees this proposed change as a potential opportunity to rationalise electricity industry codes. It makes sense to Energy UK members that the governance of the industry codes should reside with the GBSO.

Ofgem has highlighted that it expects the “GBSO to use competitive approaches in operating the system *wherever* this is in the consumers’ interests”. The GBSO should be acting in the consumers’ interest in every instance, particularly if the incentives are mandated correctly and encourage efficiency. The GBSO should *always* be considering what is cost effective for the consumer when taking an action.

Energy UK fully supports the final objective to drive forward cost-effective approaches to fostering innovative, flexible and smart solutions including demand-side response. Central to this is a long-term view of the evolution of the system, to ensure the short-term and long-term cost impacts on consumers are carefully balanced.

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

Energy UK believes that throughout this transition, the GBSO should be transparent about timings on next steps. Any changes and costs associated with the implementation of the objectives should be made with advanced warning and in a clear and transparent way. The costs that are outlined in Appendix 2 should be closely scrutinised by Ofgem. While Energy UK understands that business separation needs resources, it should be done in the most cost-effective way possible.

Energy UK would like to see Ofgem and National Grid engaging with stakeholders, when appropriate, through engagement meetings, webinars and consultations to ensure transparency.

Ofgem should, at every step, be explicit and clear in what their expectations of the GBSO are.

We very much support the drive for a whole-systems approach and the drive to deliver greater flexibility going forward. However, it is not yet clear what the appropriate relationship between the SO and the DSOs will be. It is important that the future role of the SO project does not progress on the basis of one set of institutional arrangements or another, until it has been proven that it is best-suited to delivering a flexible, low-carbon, affordable energy system.

The SO should continue to take steps to enable participation by new and emergent business models and technologies in the ancillary services market. It is essential that any stacking of revenues enabled in the ancillary services market does not threaten the level playing field by unfairly advantaging existing plant or risk crowding out of new entrants. The System Operator should be considering what the system

needs, and implement unbiased ancillary services that allow for new and existing technology to participate.

The approach to separating the SO should be supportive of full separation in future if necessary, to ensure costs to the consumer are minimised in future, if full separation should be deemed in the best interest on consumers.

Significant value may be derived from taking lessons from SOs in other countries which are facing similar challenges to GB in having to adjust to increased penetration of variable renewable generation.

We very much welcome the more nuanced view to system needs taken in the System Operability Framework. These include the need for greater flexibility, beyond the simple analysis of excess system margin. Steps should be taken to further develop this approach in future to ensure the delivery of a system which is fit for the future.

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

The consultation recognises that the SO role needs to evolve in four key areas. New or enhanced outputs will be delivered by the SO. As the role of the GBSO evolves, enhanced outputs should be captured by either new licence conditions or Ofgem should provide some clarification of which existing licence conditions support delivery of those outputs. If or when licence changes are needed, Ofgem should ensure that these are made public in advance and are subject to stakeholder consultation.

Energy UK sees that the TO licence conditions for National Grid already exist (for example in the Scottish TO's licence) therefore there ought to be no change anticipated to the TO part of National Grid's licence conditions.

**Chapter Three**

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

Energy UK supports the greater separation of the National Grid GBSO function from the rest of the National Grid Group and agrees that this is a sensible way forward. In the current industry context and considering the challenges faced we believe the proposals for a legally separate SO is the right solution and can further mitigate conflicts of interest associated with the current structure. As noted, this approach does not preclude the future move to an ISO if the case is proven that this will deliver consumer value proportionate to the additional costs to industry and consumers.

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

Energy UK supports the additional separation measures. We see the separation of the TO and SO functions (which currently reside within National Grid) as an opportunity for Ofgem to reconsider the existing industry code governance structure. Members see this an opportunity to rationalise these codes where possible, particularly as European Network Codes that are being implemented over the next two years, there is an increasingly changing generation mix, faster switching is on its way and there is a move to greater Half Hourly Settlement, all of which will impact the structure and operation of the industry codes over the coming years. We support the GBSO having responsibility for code administration as it does not seem sensible to have one of the three TOs as code administrator.

Members accept that Ofgem does not intend to re-open the RIIO-T1 settlement. However, if costs incurred fall outside of this, Ofgem and National Grid have to be very clear about how these costs are going to be recovered, and give advance warning to market participants. After Ofgem's assessment of the costs, Ofgem should consult with industry about how and when National Grid can recover costs.

Energy UK supports Ofgem's proposal to separate the transmission licence. We support the relevant sections in the consultation on governance moving forward, including the separate Board. Energy UK

would also support a Board that does not have National Grid employees represented, much like the Elexon Board. Just as is set out in the consultation that 'prohibiting such cross-composition will improve the independence of the SO' (3.39).

Energy UK is, for the most part, happy with the suggested treatment of employees with regard to the separation. However, the new company should consider outside hire (as in non-National Grid, GBSO or TO or their non-regulated businesses, such as the interconnectors) for some positions when the new structure for the GBSO is decided. This would make the transition to a more separate GBSO a healthier one, as new staff would more easily embody the new identity of the GBSO.

Information should already be ring-fenced between the GBSO and TO. Energy UK supports further measures being implemented to ensure that this is happening. When implementing any IT solutions in the future, the GBSO and TO should do so separately

Members would like to see a physical separation of the GBSO and the TO parts of the National Grid Group. A robust physical separation is important to ensure a more independent culture. It would be reasonable for Ofgem to keep this issue under review. Ofgem should consider if the proposed option is sufficient to mitigate future stranded costs. No investments should be made that will be a waste of money in retrospect that consumers will ultimately be picking up.

Energy UK believes that separation may also present an opportunity for the new more independent GBSO to invest in a new website which has improved user interface functions and is separate again from the rest of the National Grid Group.

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

Energy UK would like visibility of when these changes will be implemented off the back of this consultation.

**Chapter 4**

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

Ofgem to keep in mind that industry should be consulted upon and given advance warning of any changes and costs. Engagement days, webinars, communication and consultations are appreciated throughout this process.

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