

## **Statement on the future of Electricity System Operation**

The Department for Business, Energy and Industrial Strategy (BEIS), the Office of the Gas and Electricity Markets (Ofgem), and National Grid believe that a more independent electricity system operator can realise benefits for consumers by enabling a more secure, competitive and flexible system.

Such an electricity system operator should be underpinned by a governance structure that mitigates potential or perceived conflicts of interest, and ready to adapt further as system challenges continue to evolve. This statement describes the intention of BEIS, Ofgem and National Grid to increase the independence of the system operator within the National Grid Group, and sets out how we will take substantial steps towards achieving this, subject to consultation.

**A System Operator acting in the best interests of consumers  
leading the way to a 21<sup>st</sup> century electricity system  
and a secure, sustainable and affordable future.**

1. The GB energy system is changing. A more distributed and more low carbon energy system with new technologies and new business models mean that the challenges and opportunities for consumers and the operation of the electricity system are evolving. A more independent electricity system operator (SO) with clearly defined licence objectives to address these challenges and embrace new opportunities will realise benefits for consumers by enabling a secure, competitive and flexible system. Building on enhancements to the SO's role through Ofgem's Integrated Transmission Planning and Regulation project, we believe a legally separate electricity SO within the National Grid group is the right step to take. This will allow the SO to make the necessary changes in a manner consistent with maintaining security of supply. Such an electricity SO will be underpinned by impartial governance, and be ready to adapt as system challenges continue to evolve. It will benefit consumers, with transparency, markets and competition at the heart of all its activities.
2. Government is responsible for setting the strategic energy framework and policy goals. Ofgem is the independent regulator for the electricity market and is responsible for regulating the SO and other licensees, as well as approving (and sometimes initiating) changes to industry rules and codes.
3. The electricity SO's current responsibilities include balancing the electricity system, running electricity capacity auctions, coordinating and administering aspects of industry rules and codes and supporting efficient transmission network development. The establishment of a more independent SO will provide a platform for adopting a more holistic approach to addressing electricity industry challenges for the benefit of consumers. The SO needs to work in partnership with government, Ofgem and industry parties to deliver these existing and future responsibilities.
4. Our shared objective is an electricity SO that delivers real value to consumers and provides system leadership in:
  - overseeing a safe, resilient, and cost-effective electricity system;
  - driving competition and efficiency across all aspects of the system; and
  - promoting innovation, flexibility and smart/demand-side solutions.
5. Facilitated by greater independence, the electricity SO will carry out its existing functions and take on some new ones so as to:
  - improve markets for balancing and ancillary services, and proactively lead industry in the development of market frameworks to ensure the system is operated safely, securely and efficiently in real time;

- promote competition and enable markets to innovate and drive efficient outcomes. It will do this by considering electricity markets holistically in order to promote efficiency and innovation, and to incentivise flexibility at least cost to consumers;
- promote economic and efficient whole system solutions, including smart solutions in place of traditional network investment. It will also involve coordination across the transmission-distribution interface, and developing options for new arrangements for balancing at transmission and distribution levels in partnership with distribution network operators (DNOs) and other existing and new market participants;
- facilitate competition in networks, to encourage greater efficiency, more innovation, and smart solutions; and
- help meet the Government's agreed security of supply standard to ensure a resilient and secure system, taking advantage of new technologies and approaches and the potential of competition and flexibility to achieve better value for consumers.

6. In carrying out these functions, actions of the electricity SO are likely to include:

- Engaging in trials in partnership with DNOs and other parties to facilitate the coordinated use of flexibility and develop market platforms;
- Developing balancing services and new smart approaches with industry. This will allow equal access for new market participants and new technologies to compete (such as demand side response and storage);
- Considering the commercial arrangements for network charging and so proactively work with Ofgem and industry stakeholders in the delivery of a level playing field for all market participants;
- Developing with industry an improved understanding of whole system operability challenges across the Transmission and Distribution (T-D) boundary in the System Operability Framework, with a detailed understanding of whole system operability challenges across the T-D boundary and roadmap for solutions in 2017. This will include how best to incorporate new technologies and approaches as the system gets smarter;
- Working with DNOs to define roles (SO-DNO) across the T-D interface. Further enhancing contractual arrangements to address evolving operational challenges and optimising boundary investments
- Working constructively with Ofgem and industry to ensure existing proposals for competition in networks work in the interest of consumers, and proactively exploring new opportunities to extend competition.

## **A System Operator governed in the best interests of consumers, and future-proofed for further system development**

7. Our intention is an electricity SO with a governance structure that mitigates potential or perceived conflicts of interest and is able to adapt further to the changing system in future. In order to deliver this, subject to the appropriate consultation by Ofgem, the electricity SO will:
- be incorporated in a separate company, limited by shares, which will be wholly owned by National Grid plc;
  - hold a transmission licence to operate the GB electricity system separate to the transmission owner's licence and any other licence authorising any other activity regulated by Ofgem;
  - have its own Board, with three independent directors. No members of the SO Board will also sit on the National Grid plc board or the boards of other National Grid plc electricity subsidiary companies;
  - establish a sub-committee, chaired by an independent director, with public-facing reporting requirements, that is responsible for ensuring that SO decisions are non-discriminatory and that electricity SO business separation requirements are met;
  - only have executives and managers whose annual performance bonus payment awards are linked to the performance of the electricity SO, and not to wider National Grid performance;
  - ensure electricity SO employees are physically separate from any other National Grid plc electricity subsidiary companies; and
  - have relevant information ring-fenced from other National Grid businesses and have appropriate shared service arrangements, so that National Grid's transmission owner staff will only have access to the same system information as the other transmission owners.

The move to this structure and implementation of new SO roles and activities will be done in a manner that both enables the SO to continue to perform strongly as part of the National Grid group, and positions the SO well to adapt as the electricity system evolves.

### **Delivery and review**

8. We intend to make progress towards delivery starting immediately. Ofgem are publishing a consultation alongside this statement on the principle of greater separation, the process that will be followed to achieve separation, and on ensuring clear responsibilities for the new electricity SO company. This will include the

process for the recovery of efficient additional costs associated with the separation and additional responsibilities.

9. In parallel with the Ofgem consultation National Grid will be proactively engaging with Ofgem and industry stakeholders on approaches to addressing a number of challenges including flexibility and whole system operability issues.
10. There will be additional opportunities for stakeholders to input, both in response to further Ofgem consultations and through engagement with National Grid. Ofgem's consultation sets out their plans for subsequent consultations. Following the Ofgem consultation, National Grid will launch its Future Role of the SO (FRSO) programme, including publication of programme milestones and plans for stakeholder engagement and involvement. It is expected that this will include piloting of new ways of working for the separate SO and TO in 2018.
11. Progress towards the realisation of this vision will be reviewed after April 2018.
12. This statement is non-binding and is not intended to have legal effect.