

**Response by**  
**National Grid Transco**

**to HM Treasury consultation “Financial Services and Markets Act two  
year review: Changes to secondary legislation”**

**Introduction**

National Grid Transco (NGT) is the owner and operator, via its subsidiary, National Grid Company plc (NGC), of the high-voltage electricity transmission network in England and Wales<sup>1</sup> and, via Transco plc, of Britain’s natural gas transportation system and of the majority of Britain’s gas distribution system.

NGC currently benefits from an exemption from the requirement to be authorised under the Financial Services and Markets Act (the “Act”) in respect of activities carried out in its role as electricity System Operator for England and Wales<sup>2</sup>. Transco plc similarly benefits from an exemption<sup>3</sup> in respect of activities carried out in its role as a gas transporter. As such, NGT welcomes the opportunity to respond to the consultation “Financial Services and Markets Act two year review: Changes to secondary legislation”, issued by Her Majesty’s Treasury on 27 February 2004.

This response is restricted to the issues raised in paragraphs 9.29 to 9.41 of Volume 1 of the consultation, relating to the NETA Advice Exemption (Questions 44 to 49) and related matters. As such, it is focused on the actions of NGC. The consultation document does not refer directly to Transco plc’s exemption. We assume that this exemption will therefore remain in force and that there would be direct consultation with Transco plc before any action were taken to change this.

Should you wish to discuss any of the points made in this response, please contact:

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<sup>1</sup> As part of the BETTA process, the Secretary of State has indicated that she is minded to appoint NGC as Great Britain System Operator. Ownership of the transmission networks in Scotland will remain with Scottish Power and Scottish and Southern Energy.

<sup>2</sup> Under paragraph 49 of the Schedule to the Financial Services and Markets Act 2000 (Exemption) Order 2001, as amended by section 8 of the Financial Services and Markets Act 2000 (Exemption) (Amendment) Order 2001.

<sup>3</sup> Under paragraph 42 of the Schedule to the Financial Services and Markets Act 2000 (Exemption) Order 2001.

## **Background**

NGC's involvement in the electricity markets, including both the forward markets and the Balancing Mechanism, is primarily as a counterparty to transactions with other Balancing and Settlement Code (BSC) Parties, i.e. with electricity market professionals. NGC also contracts with a number of commercial and industrial electricity users, who are able to adjust their electricity consumption (either reducing their demand or activating small generation facilities) when requested by NGC, and this is one of the methods NGC uses to source Balancing Services. These commercial and industrial electricity users are in general not BSC Parties and are not 'electricity market professionals'. They derive a financial benefit from a contractual, rather than trading, relationship with NGC.

It is open to other BSC Parties to contract with their customers to provide Balancing Services, and one can envisage a situation where technological advances might make it feasible for BSC parties to contract with small commercial and domestic consumers on a similar basis. In this response we will refer to the role of NGC or the BSC Party as that of an "Aggregator".

NGT does not consider that the activities that NGC undertakes in sourcing Balancing Services constitute giving investment advice. Rather, its role is to provide information and act as an aggregator in respect of adjustments to electricity consumption. However, in aggregating services from non-BSC Parties in the course of providing Balancing Services, BSC Parties (and/or NGC) may, under the technical terms of the Act, be open to an interpretation that they are engaging in transactions as an agent, arranging deals or giving advice.

The exemption provides clear affirmation that such activities are compliant with financial services legislation without recourse to formal authorisation and therefore acts to eliminate companies' compliance concerns.

## **Responses to specific questions**

**Q44: Do you agree that there has been no evidence of investor detriment from unregulated advice being given to investors (a) in the electricity forward markets or (b) in the course of either the Balancing and Settlement Arrangements or the provision of Balancing Services to NGC?**

NGT is not aware of any evidence of investor detriment from unregulated advice being given to investors in either (a) in the electricity forward markets or (b) in the course of either the Balancing and Settlement Arrangements or the provision of Balancing Services to NGC.

**Q45: Do you agree that only those investors who have knowledge of the electricity markets i.e. professionals are likely to consider investing in the electricity forward markets?**

NGT agrees that direct involvement in the electricity forward markets will remain the preserve of professionals. We are not aware of any direct interest in these markets from 'retail' investors who would require specific regulatory protection and do not foresee a time when retail investors would be likely to take any direct interest in these markets.

As discussed above, 'non-electricity market professional' third parties are only indirectly involved in the electricity markets, via contractual agreements with NGC or another BSC Party, acting as Aggregator. NGT does not consider that these arrangements would reasonably be regarded as investments in electricity markets that should be regulated. The third parties are not investing in the electricity markets,

they are simply providing a service to the BSC Party (or to NGC as System Operator) and are paid for providing this service.

In summary, NGT believes that investment in the electricity forward markets, and Balancing Services markets, will remain the province of professionals who do not require regulatory protection.

**Q46: Do you feel that there is a need for the Electricity Industry advice exemption?**

The scope of BSC Parties' exemption currently extends to dealing in investments as principal, or as agent, arranging deals and advising. The (Exemption) (Amendment) Order makes separate provision in respect of these same activities for NGC, which is also a defined BSC Party.

NGT believes that in respect of the provision of Balancing Services there is a continuing need for the exemption in all of these areas.

We are not aware that any potential provider of Balancing Services is discouraged from participating in the provision of Balancing Services because of concerns about the exemption of these markets from FSA supervision. Conversely, we believe that the removal of the advice exemption could raise concerns for BSC Parties about the exact status of these arrangements and may to an extent stifle the provision of these services. It would also certainly lead to increased compliance costs, which would not lead to any benefit to participants in the market for Balancing Services. This would not be in the interests of energy consumers generally.

In summary, NGT would not wish to see any change that might discourage BSC Parties from participating in the provision of Balancing Services. Consequently, in the absence of any evidence of harm, NGT supports the continuation of the advice exemption for BSC Parties, as well as the continuing exemptions in respect of dealing as principal, as agent and in arranging deals.

**Q47: Are there any BSC Parties who currently take advantage or might take advantage of this exemption?**

As discussed above, NGC as a BSC Party contracts with third parties to provide Balancing Services. Although NGC does not believe that the information we provide to potential and actual providers amounts to investment advice in the sense of the Act, nor do we believe that the providers' indirect participation in the Balancing Mechanism constitutes an investment, the exemption provides comfort for NGC that its actions, and any information it provides to third parties, do not need to be reviewed for compliance, should these activities fall within the Act's technical definitions.

We are not aware of any other BSC Party who currently takes advantage of the exemption, however the principle of providing comfort that Balancing Services procurement activities are exempt applies generally.

**Q48: Could a BSC Party take advantage of the exemption to provide investment advice (e.g. advice about financial engineering in the electricity markets) that should properly be regulated by the FSA?**

NGT is not aware of any such circumstances.

**Q49: Do you agree that the Electricity Industry advice exemption should be retained? Please explain your views.**

On the basis of the points made in response to previous questions, NGT believes that, in the absence of any evidence of investor detriment, there is a need for the advice exemption and other exemptions to be retained. The removal of the exemption could remove the clarity currently provided in order to encourage wider participation in the provision of Balancing Services.

**Other considerations**

**Necessary changes to the Financial Services and Markets Act 2000 (Exemption) (Amendment) Order 2001 for the introduction of the British Electricity Trading and Transmission Arrangements (BETTA)**

As noted in paragraph 9.41 of the Consultation, the introduction of the British Electricity Trading and Transmission Arrangements (BETTA), planned for April 2005, will necessitate revision of the (Exemption) (Amendment) Order. Specifically, Section 8 of the (Exemption) (Amendment) Order, which inserts paragraph 49 into the Schedule to the (Exemption) Order, requires revision to reflect the revised electricity transmission licensing regime, the expansion of NGC's System Operator responsibilities across Great Britain, and related terminology changes. Certain redundant provisions can also be removed.