

**ANNEX 1 – LEGAL AND FACTUAL ISSUES ARISING IN THE CONTEXT OF
OFGEM'S SECOND FURTHER CONSULTATION LETTER**

1. Introduction

- 1.1 This annex sets out, in high-level summary terms, a number of legal and factual issues which Scottish Power sees as arising in the context of Ofgem's second further consultation letter on CAP170 dated 26 January 2010 (the **January 2010 letter**). The summary is not intended to be exhaustive and we reserve the right to expand upon, or to supplement, the points made below at a future stage.
- 1.2 The points made below relate only to issues arising in the context of the January 2010 letter. Save as expressly stated below, nothing in this annex should be taken as qualifying or adjusting any submissions or representations which we have previously made in connection with CAP170, in particular in our letters of 2 July, 17 and 25 August, 8 September and 17 September 2009, which we continue to rely on and which we expect Ofgem to address fully in its decision.

2. Ofgem's overall approach

- 2.1 The Authority's decision-making functions in relation to CAP170 are subject to substantive and procedural requirements imposed by law, which include those laid down by statute and those recognised by the courts and, in the context of a code modification appeal, the Competition Commission. They include -:
- the statutory requirement to carry out and publish a proper impact assessment under section 5A of the Utilities Act 2000;
 - the principles which are applicable in carrying out an impact assessment, including principles governing a proper cost benefit analysis and the proper assessment of quantitative and qualitative benefits and detriments: see for example the Competition Commission decision in the E.ON case at 6.157 (on the need to explain qualitative assessments clearly and in detail and to substantiate them as fully as possible), 6.171 (any margin of error in quantitative assessment should be principled and clearly explained), 7.7 and 7.13 (the need to adopt a consistent and principled approach to the weighting of costs in a quantitative assessment);
 - the statutory requirement to consult on the published impact assessment, again under section 5A;
 - the requirements of procedural fairness and fair consultation as recognised by the courts and the Competition Commission: these include identifying relevant issues, providing sufficient information to enable those consulted to respond effectively, presenting the issues and information to those consulted in a fair and comprehensible form; providing proper time for response and avoiding prejudgement;
 - required standards of proper investigation and determination of facts and analysis of issues, adequacy of evidence to support both particular assessments and the overall decision, and rationality: these apply both to the impact assessment and to the decision itself;
 - the requirement properly to assess the impact of the decision on the CUSC objectives (which include both competition and efficiency), on the statutory objectives identified in the Electricity Act 1989 (which include the principal objective of protecting consumers wherever appropriate by promoting competition, and also include efficiency), on the

obligations imposed by European law (including the general EU law principles of proportionality and equality of treatment) and on the statutory and licence obligations of NGET (which include competition, efficiency and non-discrimination);

- the requirement to have regard to, and give appropriate weight to, the relevant facts and matters identified in section 175 of the Energy Act 2004; and
- the requirements of the 'Better Regulation' duties under section 3A(5A) of the Electricity Act: these include –
 - (a) the requirements of transparency and accountability, which apply to every stage of the decision process, including the impact assessment, the consultation on the impact assessment and the decision itself; and
 - (b) the requirements of proportionality and targeting action only at cases where action is needed, which are important substantive principles which should be applied both in the impact assessment analysis and in the final decision.

2.2 These substantive and procedural requirements are closely connected in this context. For example, the proper identification and analysis of the relevant issues and proper factual investigation is necessary (a) to enable proper assessment and weighing of the various objectives and proper consideration of proportionality and targeting; (b) to ensure the impact assessment is proper; (c) to enable a fair consultation is carried out and (d) to the rationality and validity of the final decision. Similarly, a quantitative analysis in an impact assessment should investigate and analyse all costs of the decision, yet this has not been done in the case of CAP 170 – there has been no proper investigation of the potential costs to generators. Failure to do this undermines the efficiency analysis, the weighing of the various objectives as well as the assessment of the purported benefits of the measure. In this and previous submissions we identify many material and very substantial defects in the identification and analysis of issues, in factual investigation and in the weighing of the relevant objectives and duties. These defects are not remedied by the January 2010 Letter. Instead, as we explain in this submission, further defects are introduced, new errors are made and there are further material failures to investigate facts, analyse issues and provide information to consultees. As a result both of the earlier material defects and the new defects, each of the applicable substantive and procedural requirements we identify above has been breached, the statutory duty to conduct a proper impact assessment has not been properly discharged, the consultation to date is defective and unfair and any decision to implement CAP 170 would be materially defective.

2.3 In addition to the points set out at length in the main body of this annex, we would also draw your attention to the supplemental points set out briefly in Table A attached to this annex.

Process

2.4 In carrying out its decision-making functions in relation to CAP170, the Authority must ensure that it observes the requirements of procedural fairness imposed by law and recognised by the courts and, in the context of a code modification appeal, the Competition Commission. It must also, as a matter of law, pay proper regard to its 'Better Regulation' duties, notably those of transparency and accountability.

2.5 We have laid out in our letter to Ofgem dated 12 February 2010 a number of specific complaints relating to procedural fairness (and to compliance with the 'Better Regulation' duties mentioned above) which arise from the January 2010 letter. These supplement the complaints previously raised with Ofgem in our letters of 17 and 25 August 2009 (and which, so as we are aware, remain un-addressed and un-remedied).

2.6 We do not propose to repeat the fresh or previous complaints in this document, but we would reiterate our call for Ofgem (and the Authority) to take all of them (together with the process complaints previously raised in the responses from other consultees (summarised in Table B

attached to this annex)) fully into account in considering how to proceed with the decision-making process. In this context, we also wish to reiterate our concern with the timetable according to which NGET and Ofgem have chosen to conduct the various consultations thus far (summarised in Table C attached to this annex). As Table C makes clear, the very short turnaround times often imposed for consultation responses stand in stark contrast with the generous periods allowed by NGET/Ofgem for their own contributions.

- 2.7 In our submission, the procedural failings which our complaints serve to highlight should lead to the abandonment of the present decision-making exercise in the interests of fairness. Should the Authority proceed to make a decision approving CAP170, such a decision would (as a consequence of these failings) be vitiated by an error of law.

Shifting rationale for CAP170

- 2.8 In our submission, the January 2010 letter reveals a fundamental shift in the rationale envisaged for CAP170. In its amendment report to the Authority dated 25 March 2009, NGET explained the purpose of CAP170 as follows:-

"3.5 *At derogated non-compliant transmission boundaries the need to take action to manage constraints is more onerous than at compliant transmission boundaries. As such, the use of intertrips (assuming it is more economic than alternative Bid-Offer action to constrain generation pre-fault) is a necessity rather than an occasional tool in order to maximise flows across the derogated non-compliant transmission boundary. This can be demonstrated by the volume of constraints at the Cheviot boundary (presently the only derogated non-compliant transmission boundary) which is forecast to outturn at 3127 GWh in 2008/09 and compares to the rest of England, Wales and Scotland which is forecast to outturn at 1849 GWh in 2008/09. Further, the cost of managing constraints on the Cheviot boundary is forecast to outturn at £153m in 2008/09, whereas the rest of England, Wales and Scotland are forecast to outturn at £85m in 2008/09.*

3.6 *One tool available to National Grid, as System Operator, to manage constraints is the use of intertrips. Whilst intertrips are armed pre-fault, the principal cost is incurred post-fault following tripping. Therefore, based on the low probability of tripping they should represent a more economic and efficient means for managing constraints than the alternative Bid-Offer action to constrain generation pre-fault. Administering prices for intertrips capable of being armed in respect of derogated non-compliant transmission boundaries would offer a useful means to limit potential costs.*

3.7 *Therefore, CAP170 seeks to introduce a new category of System to Generator Operational Intertripping Scheme to cover intertrips capable of being armed only with respect to derogated non-compliant transmission boundaries" (footnote omitted).*

- 2.9 None of the reasons for promoting CAP170 given above, nor the justifications as to why CAP170 better facilitates the applicable CUSC objectives given in section 4 of the amendment report, suggest that CAP170 was being tabled in order to tackle the abuse of market power behind derogated non-compliant boundaries (**DNCBs**). Indeed, as Ofgem notes in paragraph 1.10 of its Impact Assessment document published on 21 May 2009, CAP170 was conceived of as a temporary measure designed (in response to Ofgem's February 2009 open letter) to address, "*the significant level of forecast constraints costs and the fact that the rate at which constraint costs are incurred will increase significantly in the summer months [i.e. of 2009] (when the planned Cheviot outage programme commences)*".

- 2.10 Ofgem did raise the issue of market power in its Impact Assessment (see in particular paragraphs 3.29 to 3.35). Ofgem notes at paragraph 3.31 of that document that, where a transmission constraint arises at a DNCB, "*NGET has limited option for alternatives such as rearranging outages, and is more likely to seek actions from generation to manage the constraint. In these circumstances, there **may be** increased scope for undue market exploitation, and where market power exists in the primary markets it will often arise in the ancillary market as the providers of the product/service are the same*" (our emphasis).

Paragraph 3.34 of that document states that, "*CAP170 could apply to any non-compliant boundary, and there might be expected to be positive impacts in terms of reduced costs to the extent that a Category 5 Intertripping Scheme replaces more costly alternative actions behind such boundaries. However, in the circumstances discussed in our recent consultation on market power issues referred to above, we consider that the expected benefits associated with CAP170 could be more significant*". The 'recent consultation' mentioned in that statement is the Ofgem consultation paper entitled, "*Addressing Market Power Concerns in the Electricity Wholesale Sector - Initial Policy Proposals*" dated 30 March 2009 (the **Market Power Consultation Paper**).

- 2.11 Chapter 1 of the Market Power Consultation Paper does briefly discuss 'market power concerns' in the context of the BETTA market, including factors which, in Ofgem's view, might exacerbate the scope for undue exploitation of market power, such as "*the current shortage of transmission capacity relative to the transmission entry rights sold to generators, the reduced availability of transmission capacity as a result of outages related to the investment programme to upgrade capacity, a significant increase in new renewable generation connecting to the system, much of which is located behind existing constraints, and environmental legislation limiting the use of certain types of generation capacity*" (paragraph 1.9). However, the only evidence or analysis purported by Ofgem to illustrate these concerns in relation to the BETTA market relates exclusively to constraint costs arising in respect of the Cheviot Boundary (see paragraphs 1.11 – 1.13 of Chapter 1 and paragraphs 1.13 – 1.21 of Appendix 2 of the Market Power Consultation Paper).
- 2.12 Ofgem suggests in the Market Power Consultation Paper that, "*[a]pplying observed pricing differentials [i.e. between generators in Scotland and England & Wales] to forecast constraint volumes in 2008/09, in a worst case scenario the potential direct costs attributable to undue exploitation of market power [on a GB-wide basis] could be as much as around £125m*" (paragraph 1.15 (footnotes omitted)), although Ofgem offers no evidence or analysis in support of its 'worst case scenario' of these 'potential' costs.
- 2.13 In the January 2010 letter, in the section headed 'Competition' beginning on page 5, Ofgem notes that, "*a number of respondents do not agree that sufficient evidence has been presented to justify replacing an existing market-based mechanism with an administered price solution*", and then goes on to state that it considers it appropriate, "*to set out in more detail and consult on evidence and analysis which we consider demonstrates a market-based solution is currently unlikely to deliver the most efficient outcome in relation to the provision of intertrip services **behind the existing Cheviot boundary***" (our emphasis). We note that Ofgem also confirm earlier in the January 2010 letter that whilst, "*[t]here is currently one boundary for which the Authority has granted derogation from the National Electricity Transmission System Security and Quality of Supply Standard (NETS SQSS) – the Cheviot boundary [...][t]here are likely to be further derogated boundaries as a result of the approach we have stated we will take to NETS SQSS derogations to facilitate earlier connection of additional generation*" (footnote 9).
- 2.14 In our submission (and leaving to one side our views on the 'evidence and analysis' presented by Ofgem (on which see section 4 below)), there is nothing in the January 2010 letter (or for that matter its Impact Assessment or the Market Power Consultation Paper) which seeks to demonstrate why a market-based solution is unlikely to deliver the most efficient outcome in relation to the provision of intertrip services behind DNCBs other than the Cheviot boundary. This is an important omission given that approval of CAP170 will have an immediate impact on the market for balancing services in those areas likely to be located behind future DNCBs.
- 2.15 Given that CAP170 is designed to apply to generators located behind all current and future DNCBs – and given the acknowledged likelihood of further DNCBs¹ – it is inappropriate for Ofgem to justify the imposition of administered arrangements by reference to alleged market failure behind the Cheviot Boundary. Were it to rely on such an approach in approving

¹ The prospect of further DNCBs has also recently been acknowledged by consultants engaged by DECC: see Redpoint, "*Improving Grid Access: Modelling the Impacts of the Consultation Options: A report on the first and second stages of a study for the Department of Energy and Climate Change, January 2010 – URN 10D/519*" (January 2010), section 7.2.1.

CAP170, the Authority would discriminate between affected generators (by failing to take into account differences in the market conditions behind different DNCBs) contrary inter alia to the requirements Article 3 of the Internal Market in Electricity Directive. In so doing, the Authority would also be acting disproportionately, i.e., by imposing arrangements which are patently not tailored to address the alleged mischief (and thereby failing, e.g., to have proper regard to its 'Better Regulation' duties).

- 2.16 This failure is compounded in two respects. First, Ofgem has chosen to present GB constraint costs as a whole within the context of market power concerns which are nonetheless expressed to relate solely to the Cheviot Boundary. On page 2 of its letter, for instance, Ofgem states, "*Constraints costs have risen from £70m in 2007/08 to £261m in 2008/9 and are forecast to be approximately £206m in 2009/10 and £322m for 2010/11. These rising costs should be seen in the context of our recent consideration of market power issues and the potential for market power to influence the costs of constraints*". Ofgem makes no attempt in its letter to analyse the various factors giving rise to the increase in overall constraint costs – or the actual proportion of this increase that could in any event be related to any market power concerns at the Cheviot Boundary. Second, whilst Ofgem acknowledges in the January 2010 letter that it would be appropriate to consider how long CAP170 should remain in place (although without indicating how any temporal limitation would be imposed), Ofgem provides consultees with no analysis as to the expected impact of CAP170 on GB constraint costs over its potential lifetime, e.g., by reference to the number and size of DNCBs which might exist in future.

Failure to assess proportionality in light of alternatives

- 2.17 Having revealed its new rationale for CAP170, i.e., the mitigation of alleged abuse of market power on the part of generators behind the Cheviot Boundary, Ofgem fails properly to assess the proportionality of CAP170 against the alternatives available to it for that purpose in light of its wider statutory duties. Again, this failure also represents a threatened breach of the Authority's 'Better Regulation' duties.
- 2.18 It is true that Ofgem does point to the alleged inadequacy of competition law (as compared with CAP170) in dealing with the risk of abuse of market power behind the Cheviot Boundary. However, Ofgem fails to provide any assessment of the relative costs/benefits of CAP170, as a means of tackling abuse of market power, compared with the powers proposed to be conferred on the Authority to address cases of undue exploitation of market power which are contained in the Energy Bill (or for that matter the powers previously proposed by Ofgem to be taken under a 'Market Power Licence Condition').
- 2.19 Clause 18(6) of the Energy Bill is designed specifically to deal with exploitative behaviour in relation to commercial intertrip contracts, referring to a situation in which, "*the transmission system operator may, or is to, pay the licence holder an excessively high amount in connection with the licence holder preparing for the possible cessation of generation of electricity by particular generating plant in the relevant period*". In her evidence to the Public Bill Committee responsible for scrutiny of the Energy Bill on 19 January 2010, the Energy Minister pointed out that there was evidence to suggest that arming fees for commercial intertrip services had not always been priced reasonably (although she did not provide any indication to the Committee as to the nature or source of this evidence) and went on to explain to the Committee that the Clause highlighted above, "*aims to prevent such exploitative behaviour*" (Col. 343, Committee Stage: 10th Sitting: House of Commons: 19 January 2010).
- 2.20 In its evidence to the Public Bill Committee on 5 January 2010, Ofgem (represented by Sarah Harrison, Senior Partner for Sustainable Development) made the following statement in relation to the relevant clauses in the Energy Bill:-

"We have asked the Government to look at introducing the arrangements for the market power licence condition in this Bill. There is the need for significant investment in transmission assets. We also have significant increases in demand for new energy and generation connections—new renewable connections. Until that investment fully comes on stream, we

will be operating on a network that suffers from severe constraints in some parts. Therefore, in those situations, it may be possible for generators to take advantage of those, to unduly exploit the situation. The impact of that falls on costs—the costs of having to take action to keep the system in balance—which are borne by customers. Our own analysis of that, looked at in 2008-09, was that £125 million of costs could be attributed to the grid having to take such actions. So, those are the particular circumstances that we are facing.

The Competition Act is available, and we have looked at trying to use it. One of the things you have to do when prosecuting under the Competition Act is to establish a position of dominance. You have to do that before you can establish whether or not there has been an abuse of that dominant position. Our efforts to use the Competition Act have been challenged in the sense that it is quite difficult to establish dominance in our electricity markets, which are temporal markets, and, therefore, to establish abuse. We began a Competition Act investigation, but our conclusion was that the chances of a successful prosecution under that Act were quite difficult, and, therefore, it was more sensible for us to use our resources elsewhere.

I know that there is some concern about the MPLC. We have been working with the Department of Energy and Climate Change on this, trying to develop a very targeted and tailored approach that will deal with a very specific set of issues. It will also have, wrapped around it, some additional protections, which is why, for example, primary legislation is important because one of those protections is to give generators, which might be subject to an investigation or finding by Ofgem under this new condition, the right to appeal to the Competition Appeal Tribunal. We cannot confer that right through the ordinary licence route; that can only be enabled by primary legislation. We think that that is an important protection that should be there. The proposal is, as you will no doubt be aware, that this is a time-limited power. So, it is very focused and targeted on a particular set of circumstances or situation as I described at the outset of my remarks. The other protection is that we will provide guidance on how we propose to enforce this condition if and when it is developed. Those measures combined push towards what we believe is a proportionate measure to tackle what could be a real issue for customers in this period when we face increased investment, but a constrained network in the interim" (col.71, in response to Q.168).

- 2.21 In addition, Ofgem's memorandum submitted to the Committee (EN 13), dated January 2010, states:-
- "3.4 *Such a condition is necessary as existing competition law makes it difficult to tackle such behaviour given the specific characteristics and complexities of the energy market. A MPLC on generators would strengthen Ofgem's powers to carry out ex-post investigations of generator behaviour and would enable us to stop undue behaviour and impose financial penalties.*
- 3.5 *We believe it is a proportionate approach that strikes the right balance between protecting both consumers and competitors from undue exploitation of market power while minimising the risk of increasing investor uncertainty".*
- 2.22 Ofgem's memorandum echoes the explanatory notes to the Bill, which state (at paragraph 94) that the objective of the relevant Clauses is, *"to provide a targeted and proportionate provision that will address the exploitation of market power whilst avoiding unnecessary uncertainty in the electricity wholesale market in Great Britain which could undermine investment in generation and, hence, security of energy supply"*.
- 2.23 The January 2010 letter fails properly to compare and assess, as alternatives to CAP170, the suitability of measures such as the MPLC, which are clearly designed to pursue the same objective as that envisaged by Ofgem for CAP170, but do so in different ways, e.g., by targeting exploitative behaviour on an *ex post* (as opposed to *ex ante*) basis. Nor does the January 2010 letter seek views on such alternatives. As a consequence, the Authority is placed in a position of potentially approving CAP170 without a proper impact assessment and consultation having been carried out on the proposal.

Lack of rigour/transparency

- 2.24 By way of introductory remarks, we would point out that Ofgem's approach to the analysis set out for consultation in the January 2010 letter demonstrates a signal lack of rigour and of transparency. In particular:
- 2.24.1 First, Ofgem has failed to adequately demonstrate a lack of competition in the provision of balancing services, including intertripping services: this applies both to the Cheviot boundary and to the likely further derogated boundaries.
- 2.24.2 Second, the 'competition analysis' set out in Appendix 1 to Ofgem's letter omits any analysis or discussion of the history and evolution of the competitive market for balancing services behind the Cheviot boundary, e.g., as to the development and introduction of new products and services, or as to the nature and extent of new entry.
- 2.24.3 Third. Ofgem's 'competition analysis' entirely overlooks the wider history and development of the competitive market for balancing services within Great Britain, notwithstanding the fact that CAP170 is designed to apply to intertrip provision behind all derogated non-compliant boundaries and not merely the Cheviot boundary.
- 2.24.4 Fourth. The January 2010 letter contains no evidence or analysis demonstrating the relative inefficiency of a market based solution to the provision of intertrip services behind the existing Cheviot boundary as compared with, e.g., that proposed under CAP170.
- 2.24.5 Finally, the engineering issues raised in our response to the Impact Assessment and the major impact they have on the proper remuneration for the service have not been addressed.
- 2.25 Given that each of the above areas are important matters on which consultees such as Scottish Power are likely to wish to express a view, Ofgem's failure to identify and analyse them seriously undermines the transparency of the consultation exercise undertaken via the January 2010 letter.
- 2.26 In consequence, a decision to implement the proposed amendment would further be wrong in law because: (a) there is no proper factual or evidential basis for a decision to implement CAP 170; (b) no adequate impact assessment has been carried out and published as required by section 5A of the Utilities Act; (c) the consultation is and remains substantially defective – material issues have not been adequately identified or explained to consultees and consultees have not been provided with adequate information or adequate time to respond; and (d) the decision process, including the impact assessment and the consultation, has not been conducted with adequate transparency and accountability as required by section 3A(5A) of the Electricity Act and any decision to implement CAP 170 would be contrary to the better regulation principles.
- 2.27 In the remainder of this section we make further more detailed submissions regarding the lack of rigour and transparency exhibited in the January 2010 letter.
- 2.28 The standard of analysis in latest consultation letter is inadequate (in terms of logical or statistical defects, inadequate investigation of facts, or failures of economic analysis), having regard to the importance of CAP170 (as evidenced by the Authority's decision to conduct an impact assessment) and the Authority's duty to set out clearly, for the benefit of consultees, the evidence and reasoning upon which proposes to rely. (See, in this regard, the CC's E.ON Decision, at para. 6.196)
- 2.29 The specific weaknesses relating to Ofgem's competition analysis (with which we deal later (at section 4)) are, in our view, indicative of Ofgem's wider failure (or reluctance) to expose its thinking and opinions to rigorous and transparent analysis. One notable feature of Ofgem's lack of rigour and transparency, is its apparent willingness to rely on the views or opinions

held by NGET – a party whose own commercial dealings with intertrip providers gave rise to CAP170 – in the January 2010 letter.

- 2.30 The letter notes, for instance, that intertrip prices in Scotland have reduced in 2009/10 and then adds, "*NGET considers that the reduction is primarily due to the regulatory attention that has been focused on the constraint costs*" (footnote 16). We asked Ofgem on 11 February what evidence had been supplied by NGET to Ofgem in support of this view and were advised by emails dated 15 and 22 February that NGET had in fact provided no material on this issue beyond the information set out in paragraph 4 of its response to Ofgem's July 2009 consultation on CAP170. According to Ofgem's email of 15 February, "*We simply reflected in our January consultation NGET's view of what it considers to be a possible explanation for the changes that resulted in reduced constraints costs for 2009/10, in the period soon after Ofgem had highlighted the issue of rising constraints costs and market power issues, and proposals such as CAP170 were raised*".
- 2.31 We set out below a table comparing, first, the contents of paragraph 4 of the NGET response document and, second, the statement made by Ofgem in footnote 16 to the January 2010 letter:

NGET consultation response, para. 4	Fn.16 to January 2010 letter
<p><i>Whilst this reduction in cost is encouraging, it is important to note that the contracting strategies and commercial arrangements cannot guarantee a long-term or sustainable reduction in costs as such services are able to be withdrawn or renegotiated at short notice by the contracting parties. Therefore, whilst the success of such recent activities has seen a marked reduction in costs associated with the use of intertrips in the current year 2009/10, unfortunately this cannot be guaranteed going forward. As such, National Grid continues to believe that CAP170, through introducing administered prices for intertrips capable of being armed with respect of derogated non-compliant transmission boundaries, remains important through having the potential to significantly reduce constraint costs on a long-term and sustainable basis.</i></p>	<p><i>While intertrip prices in Scotland have reduced in 2009/10, they are still far above England & Wales levels. In addition, NGET considers that the reduction is primarily due to the regulatory attention that has been focused on the constraint costs issue and that the prices achieved this year are unlikely to be sustained without regulatory intervention.</i></p>

- 2.32 It is clear from this table that Ofgem has, at best, misunderstood NGET's response document by claiming that NGET considers cost reductions to be primarily due to regulatory attention when that document in fact makes no such statement. As it happens, of course, Ofgem now appears to have shifted its own position from that set out in the January 2010 letter by reinterpreting (in its 15 February email) NGET's response document as indicative of the view that regulatory attention was merely a "possible explanation" for cost reductions.
- 2.33 In our submission, the approach taken by Ofgem in this respect is flawed both as regards its analysis of the underlying facts and also the manner in which that analysis has been presented to consultees.

Interaction with Locational BSUoS proposal

- 2.34 As we pointed out in our letter of 12 February 2010, none of the material produced to date on CAP170 sheds any light on the interaction between CAP170 and the parallel process under which Ofgem is considering Locational BSUoS. The manner and extent to which any reduction in constraint charges incurred at the Cheviot Boundary feed through to consumers

would appear to us to be significantly affected by whether Locational BSUoS is in place. Given that Ofgem's Impact Assessment relies on assessing a reduction in charges and assuming that it is passed to customers, it is essential that this interaction is explored and the results of that consideration presented to consultees.

- 2.35 Ofgem's failure to take the opportunity presented by the publication of the January 2010 letter to explore this interaction and invite views further undermines the fairness and robustness of the Authority's decision-making process.

3. Current thinking (other than competition)

Longevity

- 3.1 Ofgem notes under the heading 'Longevity' in the January 2010 letter that, "*CAP170 was originally intended to be a short term measure. If we were to approve CAP170 we agree with respondents that it would be relevant to consider how long it might be appropriate for the proposal to remain in place*".
- 3.2 Whilst we agree with this sentiment, it is inappropriate in our submission for Ofgem to express it without also making clear to consultees precisely how Ofgem or the Authority, as a practical and legal matter, would go about giving this matter consideration. Given that CAP170, as currently proposed, would remain in place indefinitely, it is not as we see it competent for the Authority to impose any temporal limitation on its approval. On that basis, Ofgem would appear to have erred in law (and/or failed in its duty of transparency) in raising as a relevant matter something which neither it nor the Authority has power to entertain.

Remuneration

- 3.3 We note, first of all, that Ofgem repeats in the January 2010 letter the factual error contained in its Impact Assessment regarding the level of remuneration imposed under CAP076. It asserts that the administered price under CAP076 was "*developed by the CAP076 working group*", echoing the statement in paragraph 3.37 of the Impact Assessment that the CAP076 administered price, "*was determined to be reasonable by the CAP076 working group*". Neither of these statements is true. In fact, as we pointed out in our response to the Impact Assessment (see paragraph H.5.7 of Annex 1), the CAP076 working group recommended that CAP076 (as originally proposed) and four working group alternative amendments should proceed to wider consultation. These alternatives involved supplementing the original proposal with (a) a bilaterally agreed arming fee based on the cost of insurance, (b) an administered arming fee specified in the CUSC, (c) a post event claims process for any resultant physical plant damage and (d) an administered arming fee specified in the CUSC plus a post event claims process for any resultant physical plant damage (i.e. (b) plus (c)). It was the Authority - and not the working group - which determined that the administered price under CAP076 in its originally proposed form should be imposed.
- 3.4 We would add at this point that, to the extent the CAP 076 administered price determined by the Authority is not (by contrast with the alternatives put forward by the CAP 076 working group) cost-reflective, then there is no basis for assuming that applying them to CAP 170 will lead to a more 'efficient' result than the status quo (i.e. commercially negotiated intertrip prices); thus, there is no basis for a finding by the Authority that the imposition of such a price this will better facilitate achievement of the CUSC efficiency objective.
- 3.5 We also note that nowhere in the January 2010 letter does Ofgem acknowledge the submissions made by Scottish Power as to the significant engineering impacts resulting from the provision of intertrip (including the expert report from PB Power submitted with our letter of 8 September 2009). We consider that the thrust of these submissions, which highlight the

variable nature of these impacts (by reference to plant age and condition), could at the very least have been reflected in the January 2010 letter in the interests of assisting consultees who wish to respond to the 'current thinking' on the question of remuneration. We note in this context that Ofgem state at paragraph 1.24 of the Annex to the January 2010 letter that, "*the actual resource cost associated with 'arming' an intertrip device is minimal [...] In the rare event of a fault actually occurring, generators are compensated via the tripping fee*". This statement appears entirely to ignore the potentially substantial costs (highlighted in our previous engineering evidence) if generating plant is damaged as a result of a trip and there is a substantial outage, i.e., costs which are not covered by the CAP 076 administered price.

- 3.6 At a fundamental level, however, Ofgem appears still not to grasp the significance of the engineering evidence submitted by Scottish Power. Ofgem asserts in the January 2010 letter that the price proposed under CAP170 "*is likely to be **broadly appropriate***" (our emphasis). It is precisely because of the variability of plant age/condition etc that prices paid for commercial intertrip need to be capable of being individually negotiated. Ofgem has had over four months since the submission of our engineering evidence within which to consider its significance in relation to a matter (i.e., remuneration) to which it is plainly relevant. And yet Ofgem fails to offer any thoughts on the issues raised in that submission, or even to draw consultees' attention to it.
- 3.7 Finally, we note that Ofgem now accepts, for the reasons listed in the January 2010 letter, that the administered price imposed under CAP 076 may not, in fact, be appropriate in the context of CAP 170 and that it may be appropriate for a more cost reflective price to apply to the provision of a Category 5 intertrip scheme. Having accepted that this is the case and having failed thus far to adduce any robust evidence or analysis to support the cost reflectivity of the CAP 076 price in this context (let alone the ability of such a price to reflect the economic value of the service provided to NGET), it is not in our submission open to Ofgem (or, in turn, the Authority) to rely on the possibility of some future CUSC modification to justify the imposition of that price in the interim. Such a conclusion, i.e., that the remuneration may not be appropriate, should properly result in a rejection of the proposal. To do otherwise is to expose affected generators to discrimination (as compared to CAP 076 generators) and to impose a mechanism which is admitted to be disproportionate. It would also be (or risk being) inconsistent with the CUSC efficiency objective and with the Authority's duty (under s.3A(2)(b) of the Electricity Act 1989) as regards the ability of generation licence holders to finance the functions imposed on them by CAP170. All of these defects would continue for any period during which CAP 170 is imposed on the basis of the CAP 076 price.

4. Current thinking on competition

- 4.1 In our submission, there are serious flaws in the 'current thinking' set out in the January 2010 letter as regards competition and, in particular, the analysis set out in Appendix 1 to the letter. The Oxera report comprised in Annex 2 (Economic Annex) to our consultation response describes in detail a number of those flaws and we would request that the Authority gives careful consideration to that report in reaching its decision on the proposed amendment.
- 4.2 The purpose of this section is to reinforce certain of the points made by Oxera as mentioned above (along with those made in Annex 3 (Market Development)) and to include certain further submissions in relation to the 'current thinking' on competition set out in the January 2010 letter.

Deficiencies revealed in Annexes 2 and 3 of our response

- 4.3 Both Annexes 2 and 3 to our consultation response reveal serious deficiencies in Ofgem's approach: (a) as regards the collection and assessment of factual, statistical and economic evidence, (b) the identification and analysis of relevant issues and (c) the presentation of evidence and analysis to consultees. These deficiencies are sufficient, if left unaddressed by Ofgem or the Authority, to prevent the consultation presently being undertaken on the Impact

Assessment (and, thus, the Impact Assessment and eventual decision themselves) from satisfying the requisite legal standards (e.g. as to fairness, transparency and accountability) for such an exercise.

- 4.4 In that respect, we would highlight (without prejudice to the foregoing generality) the deficient approach taken to the statistical analysis presented in Appendix 1 to the January 2010 letter. In that respect we would refer, for instance, to the point made at paragraph 3.3 of Annex 2 regarding the misleading presentation of BM price differences and the point made under the heading "*Commercial Intertrip Prices 2009/10*" in Annex 3 as regards the misleading presentation of average prices for commercial intertrips in Scotland.
- 4.5 Further, with reference to the discussion in Annex 3 to NGET's procurement approach, Ofgem has failed to undertake any analysis or consultation on the extent to which the development of competition in the balancing services market has reflected or been affected by the particular commercial or negotiation strategies pursued by NGET as the monopoly purchaser of those services (having regard, e.g., to the operation of the SO incentive scheme).

Further deficiencies in 'current thinking' on competition

- 4.6 Ofgem states on page five of the January 2010 letter that, "*We consider that the market power concerns identified in the context of our Competition Act investigation into the Scottish market, and discussed further in our consultation on addressing these concerns, are a strong indication that the existing market arrangements are not effective*".
- 4.7 It is inappropriate in our view for Ofgem to seek to rely in this context on 'concerns' previously expressed by it (either in its Competition Act investigation or in the Market Power Consultation Paper) as providing an indication (let alone a 'strong' one) of the ineffectiveness of existing market arrangements. Not only is this an example of circular reasoning, but it appears to suggest prejudgement of the issues on which Ofgem is consulting.
- 4.8 We also note that Ofgem concludes the discussion in Appendix 1 to the January 2010 letter by stating that, "*the magnitude of the problem may justify a requirement for intertrip prices to be administered*" (paragraph 1.33), presumably referring to the alleged ability of Scottish generators to price their balancing services in the way described at paragraph 1.32 of the Appendix.
- 4.9 This statement (which does not explain what is meant by 'magnitude' or, e.g., what relevant factors Ofgem has taken into account in assessing that notion) provides consultees with no suitable context or frame of reference within which to respond to the latest consultation on this particular issue. This represents another failure by Ofgem to satisfy the requirements of fairness, transparency and accountability imposed on it and the Authority by law.

5. Conclusions

- 5.1 In view of the further legal defects highlighted above (taken together with all of the defects previously highlighted in our correspondence with Ofgem) we would call upon the Authority to bring the present decision-making exercise to an end by rejecting CAP170 at the earliest possible opportunity.

23 February 2010

TABLE A – ADDITIONAL COMMENTS ON STATEMENTS MADE AND ISSUES RAISED BY OFGEM

Ref. (page/para.)	Statement/Issue	Comment
Annex 1.19	<p>“... it is the assessment of intertrip prices in Scotland that is most relevant in determining whether there may be competition problems ...”</p>	<p>This appears wrong in principle as the market as defined by Ofgem is the balancing services market.</p> <p>Much of Ofgem’s previous analysis concerned alleged market power exploitation in periods before commercial intertrip had been introduced.</p> <p>Commercial intertrip is a new and developing product in the balancing services market. It was introduced in mid 2006 in Scotland. NGET has over the short time since then increased its procurement of the service and approached new entrant(s). But the available data on intertrip prices in Scotland relates only to a short time period and commercial intertrip in E&W is even newer. There is not sufficient volume of E&W intertrip contracts to serve as a satisfactory benchmark for Scottish intertrip prices.</p> <p>(Further - see comments below against Annex 1.20 and Annex 1.23).</p>
Para 1.22	<p>Until recently there was only one Cheviot intertrip provider. Now there are two, but one is the key player because of the nature of the plant.</p>	<p>There is a failure to elaborate on who this "key player" is or why they are important. This is a failure of transparency and of procedural fairness. We would wish to analyse and contest the basis of this statement, but are practically inhibited by the failure to provide the necessary information.</p>
Annex, 1.23	<p>Ofgem note (footnote 16), "<i>While intertrip prices in Scotland have reduced in 2009/10, they are still far above England & Wales levels. In addition, NGET considers that the reduction is primarily due to the regulatory attention that has been focused on the constraint costs issue and that the prices achieved this year are unlikely to be sustained without regulatory intervention</i>".</p>	<p>Please see Annex 1 (paragraph [2.27 to 2.30]), Annex 2 (paragraph 3.4) and Annex 3 (section headed. "Commercial Intertrip Prices 2009/10")</p> <p>The first sentence is not reliable.</p> <p>Apparently Ofgem has not taken account of all Scottish intertrip contracts (see Confidential Annex (as referred to above)). And the comparison between Scottish and E&W prices is not sound as a matter of statistical methodology inter alia because of the much</p>

Ref. (page/para.)	Statement/Issue	Comment
		<p>smaller data set for E&W and the very limited time periods under consideration.</p> <p>The second sentence is wrong.</p> <p>As a result of questions we asked about the source and basis for the statement in the second sentence, Ofgem has confirmed that there is no source. Ofgem have informed us that NGET only considers that regulatory attention is a 'possible explanation'</p> <p>There is no analysis in Ofgem's January 2010 Letter of another more plausible explanation for the reduction in Scottish prices – that it is due to the development of this new product in a competitive market, including greater negotiating experience by NGET and the introduction of a new entrant generator.</p> <p>Which of the two explanations is right has not been analysed by Ofgem and not been identified as an issue for consultation responses</p> <p>No supporting evidence or analysis has been provided for NGET's 'possible explanation'. It has no more status than a guess as to a possibility. This is not a proper basis for a decision on CAP 170..</p> <p>The point is centrally material. The actual observed price movements for commercial intertrip in Scotland are downwards, which provides evidence of an effective competitive market. Ofgem should give proper weight to this evidence. It should not be outweighed by a 'possible' alternative explanation without supporting evidence, analysis or investigation. If Ofgem were minded to reject this evidence it should not have done so without a properly informed consultation with industry parties on the issue – i.e. which explanation was correct. Consultation on the issue should have been supported by all necessary information to enable consultees to respond,</p> <p>The sentence is a material error of fact.</p> <p>It is also very seriously misleading to consultees. Ofgem's correction</p>

Ref. (page/para.)	Statement/Issue	Comment
		was made at a very late in this very short consultation round and has not, as far as we are aware, been made clear to other consultees. These are material defects in the latest consultation exercise.
Annex 1.24	<i>"... the actual resource cost associated with 'arming' an intertrip device is minimal ..."</i>	Ofgem has entirely ignored the potentially substantial costs if the plant is damaged as a result of a trip and there is a substantial outage. (Longannet, insurance etc). Such costs are not covered by CAP 076 administered prices.
Annex, 1.25	Ofgem state, "There may be an argument that generators are also entitled to recover any opportunity cost associated with intertrip arming via the arming fee, which might reasonably include any revenue that may be foregone by a generator in the BM due to use of the intertrip by NGET (this could include both revenue from BM bids in the export-constrained region, as well as BM offers from plant owned by the same generator on the other side of the constraint that would otherwise have been called on to provide replacement energy). However, Ofgem has conducted analysis which suggests that this is not a significant factor in explaining the price differential between Scotland and England and Wales" (our emphasis).	CAP 076 expressly does not compensate for consequential costs, if plant is damaged – including loss of profits during any resulting plant outages. Ofgem have taken no account of the engineering evidence submitted by SP that the financial risks are variable - e.g. that the risks are greater with older plant, so that imposing CAP 076 prices (which exclude consequential costs) is even more objectionable in the case of the plant likely to be subject to CAP 170, as compared with the (newer) plant affected by CAP 076 itself. Ofgem has not addressed the discrimination and inefficiency arguments identified by SP as a result of the 'one price fits all' pricing structure in CAP 076.
Annex 1.26	<i>"Analysis of the cost of other balancing services we have undertaken indicates that both SP's and SSE's prices in the BM were significantly above short-run marginal cost (SRMC) at times of constraint. This is presented in the section below."</i>	The 'section below' contains 3 pieces of analysis – (a) a comparison of accepted BM offers from coal plant in 2007, showing identified import constraint periods; (b) a comparison of accepted BM offers from gas plant, April 2005 to August 2008, showing identified export constraint periods; and (c) a table purporting to compare accepted coal bid prices in Scotland to those in E&W which is stated to support the conclusion that the divergence between Scottish and E&W prices increases at times of export constraint, and that spreads in Scotland also increase at such times. These do not provide any cogent evidence to establish that there is

Ref. (page/para.)	Statement/Issue	Comment
		<p>any general pattern associated with periods of constraint. There appears to have been no analysis by Ofgem of the statistical and methodological issues. They appear unreliable as a matter of statistical methodology due (among other defects) to inappropriate selection of data sets and time periods.</p> <p>All three concern BM accepted bid offers – there is no analysis of the relevance of this to commercial intertrips.</p> <p>Even in the event that Ofgem's analysis establishes the proposition set out in the statement shown opposite (which is disputed), Ofgem has not explained why achieving prices above SRMC should be regarded as a badge of market power (or of the abuse of that market power).</p>
Annex 1.26, 1.27, 1.28 & Figure 1	<p>Comparison of accepted BM offers from coal plant in Scotland and E&W in 2007, noting constrained and unconstrained periods</p> <p><i>'... the chart illustrates a large differential in accepted BM offer prices during the Sept / Oct 2007 import constraint period as compared with other periods ...'</i></p>	<p>(1) There is no significant differential for the other 4 identified import constraint periods. This does not support any general conclusion that at times of import constraint Scottish generators with market power abuse that power. Contrast the first sentence of Annex 1.26.</p> <p>(2) For much of 2007 the figure shows that E&W accepted bid offers were actually higher than those in Scotland. They were markedly higher throughout the final three fortnight periods – from 19 Nov 07 to 30 Dec 07.</p> <p>(3) This chart relates to BM not to commercial intertrips (contrast Annex 1.19 above).</p> <p>(4) The time period is too short. One year only - 1 Jan 2007 to 31 December 2007.</p> <p>(5) The data set and time periods appear too short to support any statistically significant conclusion.</p> <p>(6) Why has the analysis not been extended to the present day?</p> <p>(7) There is no analysis of whether the time period is representative of</p>

Ref. (page/para.)	Statement/Issue	Comment
		<p>current (and likely future) conditions.</p> <p>(8) This data was available to Ofgem when it concluded that the likelihood of establishing a CA infringement was low. It does not now serve as a proper basis for implementing CAP 170.</p>
<p>Annex 1.29 to 1.30 And Figure 2</p>	<p>Comparison of accepted BM bids from gas plant in Scotland and E&W, related to constrained and unconstrained periods, April 2005 to August 2008.</p> <p><i>"Large BM bid price differentials may be observed in a number of export constraint periods including September 2005 and summer 2008."</i></p>	<p>As Ofgem itself recognises (1.31) export constraints are in fact present in most weeks. During most of the time when there is an export constraint, no divergence is seen between Scottish and E&W prices. Therefore this material also does not provide support for Ofgem's general assertion in the first sentence of Annex 1.26. (See Annex 2, paragraph 3.3.)</p>
<p>Annex 1.31 & Table 3</p>	<p>The data in Table 3 purports to compare accepted coal bid prices (on a volume weighted average basis) in Scotland to those in E&W, and relates these to export constraint periods.</p> <p>Ofgem claim this supports the conclusions (a) that the difference between Scottish and E&W accepted coal bid prices increases at times of export constraint, and (b) that spreads in Scotland also increase at such times.</p> <p>In turn, this is relied on to support the conclusion <i>"that there is strong evidence from our CA investigation that Scottish generators can price their balancing services in Scotland independently of their rivals in periods where there is a constraint on the Anglo-Scottish boundary"</i>.</p>	<p>There has not been sufficient disclosure of the raw data and assumptions used in this table.</p> <p>There is no justification offered as to whether the use of a volume weighted average over 3 years is statistically appropriate</p>
<p>Annex, 1.32</p>	<p>Ofgem conclude, <i>"We consider that there is strong evidence from our Competition Act investigation that Scottish generators can price their balancing services in Scotland independently of their rivals in periods when there is a constraint on the Anglo-Scotland boundary. While we have not concluded that there is a separate market for intertrip</i></p>	<p>Even if this were the case (which it is not, for the reasons given in Annex 2), Ofgem make no findings as to whether the market power held is being exploited or abused.</p>

Ref. (page/para.)	Statement/Issue	Comment
	<p><i>services, the evidence suggests that the two main providers of intertrip services in Scotland hold substantial market power in a large number of periods, which may allow them to price those services several times above both SRMC and the prices of providers of comparable services in England and Wales".</i></p>	
	<p>Missing material / analysis</p>	<p>There is no analysis of the potential positive benefits of competition in the balancing services market. For example new product development. (cf. the introduction of commercial intertrip itself – first to Scotland, then to E&W)</p> <p>There is no analysis of the features of the recent history which support a conclusion that there is an effective market in balancing services (introduction of commercial intertrip, new entrants, lower prices)</p> <p>There is no consultation on these issues.</p> <p>This is an unbalanced presentation.</p>
<p>Annex, 1.33</p>	<p>Ofgem also conclude, "<i>We consider that the magnitude of the problem may justify a requirement for intertrip prices to be administered</i>".</p>	<p>Ofgem provide no frame of reference against which 'magnitude' is to be measured. Ofgem has not properly and transparently assessed the degree of risk. It has not made a proper quantitative or qualitative assessment. It has not consulted on these issues, or provided adequate information to consultees on them.</p>

TABLE B – PROCESS COMPLAINTS FROM OTHER CONSULTEES

Part 1 – Summary of other industry responses to NGET Consultation

Party	Comments/Arguments
AEP	<p>"Members agree that the significant increase in constraint costs is a cause for concern, but are puzzled as to why the issue was left till mid February to be addressed via an urgent National Grid Electricity Transmission (NGET) review process. The potential for increased costs has been known about for as long as the planning for the Cheviot outage programme has been underway. NGET began publically to discuss the impact of constraints and outages as early as October 2007 when the issue was raised at the Balancing and Settlement Code Panel meeting. Those who have participated in discussions around the development of the System Operator Incentive Scheme for 2009/10 have been discussing potential mitigation since the review of 2008/09. Ofgem participates in this process too albeit late in the development cycle. As it would appear that this may have contributed significantly to Ofgem's sudden concern about the increased level of forecast constraints perhaps it would be timely to review Ofgem's future timetable for engagement. In addition we would appreciate additional information on why NGET's use of commercially negotiated intertrips has been defective?"</p> <p>"The CUSC panel agreed to the urgent treatment of CAP170 on the grounds of the potential for significant commercial impact on both industry and consumers. However, this has resulted in a suboptimal process leaving little opportunity for full industry consideration of the issues, and potential for the development of alternative approaches, which may have emerged had the opportunity for improved industry input been agreed¹. The omission of Working Group deliberations during the brief eight day industry review period is disappointing with the prospect of any post implementation review being limited and of little value."</p> <p>"Early industry engagement, rather than further urgent actions, is expected in order to ensure delivery of robust and appropriate solutions. In addition an indication of the 'shelf life' of proposals would be useful."</p>

<p>BWEA</p>	<p>"The modification proposal itself may be short but the issues that need to be considered are complex and merit a longer timeframe than CAP 170 allows. We understand and appreciate that Ofgem is concerned about the potential for constraint costs to rise. However, we are very worried by the nature in which these concerns are being addressed. Ofgem appears to be railroading changes through the CUSC because it can, rather than because they have been justified. There has been ample opportunity to progress these kinds of changes in the proper timescales, but instead they come shortly after a shelved competition law investigation into constraint costs. If there are concerns about the operation of the market for constraint services in Scotland, then these should be set out clearly, and debated properly. What we have had is a confidential investigation into constraint costs followed by some unsubstantiated claims about inappropriate costs and a few graphs on bid and offer prices, with no debate."</p> <p>"Under any circumstances this kind of change would necessitate very careful consideration. We simply have not seen any credible or substantiated case for urgency that would justify such a major move."</p> <p>"The consultation refers to the obligation under the CUSC to have a Working Group review of CAP 170 post implementation. Surely this review would be more meaningful if the changes proposed under CAP 170 were countenanced under time-limited, specific circumstances and were held accountable to the outcome of any review. Instead, our understanding is that CAP 170 is envisaged as a lasting measure that would extend beyond the Cheviot Boundary."</p> <p>"For the avoidance of doubt, BWEA is appalled at the way in which these changes are being progressed."</p> <p>"If there are concerns about the operation of the market for constraint services in Scotland, then these should be set out clearly, and debated properly."</p>
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<p>Centrica Energy</p>	<p>"We do not believe that 8 working days to fully analyse and assess the impact of this amendment is sufficient, especially given the legal precedents this proposal would set, as identified below. We are concerned that there has been no opportunity to consider the wider implications of CAP170, and / or an opportunity to develop better alternatives. In particular, we are disappointed that this proposal was not raised and assessed properly as part of the recent SO Incentives activity for 2009/10, which was begun early in 2009. The forecast level of constraints in 2009 has been a known issue for some time given the Cheviot outage plans (and precedent in 2008)."</p> <p>"Due to the timescales, we have not been able to conduct a detailed review of the complex legal issues noted above, and as a result Centrica reserves its position on this matter until it has conducted further work."</p> <p>"It is not clear whether alternatives can be raised and it appears there is no time for a Working Group assessment. Given the seriousness of the issue we feel it is appropriate to make some additional recommendations for consideration. These aspects would ordinarily have been discussed as part of the Working Group and are outlined below."</p>
<p>EDF Energy</p>	<p>"We are extremely concerned with the process being followed to introduce CAP170 as it does not permit adequate industry consideration of the issues involved."</p> <p>"Neither the CAP170 amendment proposal nor the company consultation document adequately demonstrates that a defect exists within the CUSC."</p> <p>"National Grid has requested urgency for this proposal solely due to the 17th February 2009 letter from Ofgem. This letter not only contains an implicit view that Ofgem considers National Grid may be in breach of its Transmission License and the Electricity Act but also that Ofgem considered proposals should be raised urgently. It was well understood prior to the introduction of BETTA that the "Cheviot boundary" would be subject to constraints and in August 2005, Ofgem confirmed this in their determination document (C18/R/12/A). In March/April 2007 the "Cheviot boundary" received a derogation from the GB SQSS by the Authority. On 5th June 2008, initial proposals for SO Incentives indicated that total forecast network constraint costs would be £125m for 2008/09. This was increased to £194m in the subsequent consultation of 27th November 2008 consistent with the prevailing market prices at that time. At this time, National Grid provided an initial forecast of constraint costs for 2009/10 of £307m which was revised downwards to £258m on 27th February 2009. We therefore conclude that Ofgem had sufficient time to invite National Grid to raise any non-urgent proposals and suggest that the Industry is now being penalized for a lack of regulatory oversight throughout 2008 with respect to forecast constraint costs. The issue of solving the constraints in Scotland is complex (see figure 1) we would not want to sacrifice quality of solution for speed by simply replacing one set of sub optimal solutions with another."</p>

E.ON UK	<p>"We note that this Amendment Proposal arose from a letter from Ofgem to National Grid sent on 17th February 2009. The urgent status of this proposal is specifically linked in part to the imminent start of the Cheviot Outage Programme (paragraph 3.1 of Consultation Document Volume 1 refers). It is difficult to understand the requirement for urgency on these grounds, given that the planned Cheviot Programme outage dates were known when the Derogation from the SQSS was granted and revised by the Authority in March and April of 2007."</p> <p>"The changes required to CUSC by this Amendment Proposal, and consequentially to the Grid Code, are detailed and potentially complex, and merit Working Group development before consultation. Use of the urgent amendment process in the CUSC is inappropriate for changes of this complexity, especially given the interactions across different codes and with the Procurement Guidelines. The Amendment Proposal should ideally have been raised much earlier to avoid this situation."</p> <p>"As mentioned above, this Amendment Proposal has been raised and deemed to be urgent for the treatment of one specific derogated transmission boundary. It is incomprehensible that this boundary is not defined clearly and specifically, especially in the light of the changes which would be imposed upon generators in the event this Proposal is approved."</p> <p>"The Urgent process applied to this Amendment Proposal makes a review of payments impossible."</p> <p>"Any change introduced with so little time for consideration and consultation should be drafted as tightly as possible to address the exact difficulty perceived. This principle has not been followed in the preparation of CAP 170, and so E.ON UK cannot support it."</p>
First Hydro Company	<p>"We are unclear why Ofgem has asked National Grid to bring forward this proposal, on an urgent basis, and at a very late stage ahead of the next incentive year. The issues around constraints are significant and fuller debate and consultation with market participants is warranted."</p> <p>"The proposal is being progressed via the Urgent CUSC route. This fast track route does not allow for alternatives or changes to the legal text after the initial consultation. We do not believe that the Urgent CUSC route is appropriate for what is such a significant and fundamental change to the market arrangements. We believe that proper debate via the normal working group process is essential, with the ability to raise alternatives if appropriate."</p>

Magnox North Ltd	<p>"It is difficult to understand why CAP 170 was considered to merit urgent status. The issue of constraints on the transmission system between Scotland and England was well known in the industry well before BETTA, and the way that BETTA was introduced could be seen to exacerbate the constraints issue. It was also well understood in the industry that works to relieve the constraints after BETTA started would necessarily cause additional constraints while the works were being carried out. Consequently, it seems strange to require an urgent modification to the CUSC, more than four years after BETTA started, to alleviate a problem that was known about long before."</p>
Nuclear Decommissioning Authority	<p>"Difficult to understand why CAP170 merited urgent status as the issue of constraints is well known. "</p>
RWE npower	<p>"CAP170 appears to have been introduced in response to the letter from Ofgem dated 17th February regarding constraints on the GB transmission system. This letter highlighted that the forecast costs of constraints on the GB transmission system were set to rise by 10% from the 2008/09 level to £262m in 2009/10. In this context it would be appropriate for National Grid to provide information on the extent to which constraint cost savings have been and can be delivered through the use of commercial intertrips when compared with alternative means of managing the constraints such as acceptance of bids and offers in the balancing mechanism, particularly across the currently derogated non compliant Cheviot boundary. We assume that the arming of a commercial intertrip has been more economic and efficient when compared with the alternatives available. This data should enable an economic comparison to be made between the cost savings arising from administered arrangements envisaged under CAP170 when compared with the cost of a service delivered through a commercial scheme or through alternative constraint management measures. This data should enable market participants to understand the level and extent of any efficiency savings envisaged under CAP170 and determines the extent to which the proposal can better meet CUSC Objective (a)."</p> <p>"Data should be provided to enable an economic comparison to be made between the cost savings arising for administered arrangement compared with the costs using a commercial scheme or using alternative constraint management measures. This data should enable market participants to understand the extent and the level of any efficiency savings envisaged under CAP 170 and determines the extent to which the proposal can better meet CUSC objective (a). "</p>

	<p>"Following on from the economic data, further information is required to understand the clear technical reasons for the introduction of a Category 5 intertrip or to understand the circumstances under which a commercial intertrip can be deemed to be a non commercial Category 5 intertrip. A Category 5 intertrip scheme should only be designated if there are clear system or competition related issues that require the arming of a specific intertrip scheme to alleviate these. This is the case for all other forms of intertrip (Category 1-4) defined in the Grid Code. Since the proposed amendment fails to define the specific system or competition related requirement for the intertrip scheme we do not believe that it can better meet CUSC Objective (a)."</p> <p>"Further information required to understand the clear technical reasons for the introduction of a Cat 5 intertrip or to understand the circumstances under which a commercial intertrip can be deemed to be a non commercial Category 5 intertrip. A Category 5 intertrip scheme should only be designated if there are clear system or competition related issues that require the arming of a specific intertrip scheme to alleviate these. The proposal fails to define the specific system or competition related requirement for the scheme and so do not consider that CUSC objective (a) is met."</p>
Scottish Renewables	<p>"An urgent CAP is not the best way to debate the merits of such a fundamental issue and we are concerned about the way this issue has emerged and developed (as far as we are aware first raised in public at our January '09 Grid Conference, then the Scottish Parliament Energy Inquiry in February '09 to the February '09 Open Letter)."</p>
SSE	<p>"We do not believe that a defect in the CUSC has been correctly identified or the case made as to why, if it does exist, how CAP170 solves that defect."</p> <p>"We believe that the process by which CAP170 was raised (at the specific direction of Ofgem) is flawed and has led to a prejudicial proposal that unfairly impacts on our business interests. Furthermore, the unreasonable way CAP170 was raised and the speed with which it has been progressed means this radical and wholly disproportionate change, if implemented, would have profoundly negative implications for the ongoing investment in new generation in the GB market, and could lead to an adverse impact on the security of electricity supplies in GB as a whole and Scotland in particular in the future. We have been unfairly denied the opportunity to fully assess the impact this substantial change on our business and the market. As a result, we have serious concerns regarding the process and would not wish such a process to set a precedent for future industry changes."</p> <p>"Whilst we can see that there might, theoretically, be some benefits along the lines suggested by the proposer, the lack of time (or detailed assessment by a Working Group) has severely hampered our ability to assess this matter."</p> <p>Four pages of letter are devoted to urgency status and lack of due process being followed.</p>

Uskmouth Power	<p>"We are very concerned by the way this modification has been raised with urgent status and with such a shortened timeframe for consultation."</p> <p>"For smaller players, such as ourselves, this type of shorten consultation period, with no working group to consider alternatives, is an extremely unsatisfactory way to approach these issues. We would further note that we do not consider the day of the consultation release to count as a working day, as the documents were circulated late at night. This was not a new issue and should not have been dealt with in this manner."</p>
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Part 2 – Summary of Industry Responses to Impact Assessment

Party	Comments/Arguments
BWEA	<p>"The consultation asks whether there are any other issues arising that haven't been considered to date because of the truncated timescales. BWEA has previously asked whether CAP 170 could be tightly defined in scope and time, to hard-code its 'interim' intent. This would also give more meaning and clout to any post-implementation review. BWEA understands that the urgent process does not allow for any changes to the original legal text, and for this reason this suggestion could not be taken up. Clearly this is a deficiency in the urgent process which extra time cannot alleviate and we would recommend that this is addressed."</p> <p>"We are, however, disappointed that something as prescriptive as CAP 170 has been brought forward before other more market-based measures have been properly aired. Administered solutions should be a last resort, not the first."</p>

Centrica Energy	<p>"There are however other factors to consider, which include a concern we raised in response to the initial NGET consultation, namely the timescales made available for such a fundamental change. Without a working group, there has been no time to consider the wider implications of CAP170 as an industry, considering factors such as the necessary switch and plant modifications, which may be considerable, as may the wear and tear that needs to be factored in to any analysis."</p> <p>"In the footnotes on page 22 of the impact assessment, it also states that the use of intertrips may change generator behaviour at a non-compliant boundary, however this has not been modeled or factored in. This is something that could appropriately be considered within a working group and it should not be overlooked. There have been a number of proposals published this year (e.g. locational BSUoS) that could add a locational element to way the Grid is operated, incentivising generators to generate in areas and at times where there are low constraints. This in itself is part of a wider movement which may be expected to incentivise beneficial changes in generator behaviour. The worked examples and associated Procurement Guidelines give a good indication of what actions NGET might take in relation to category 5 intertrips. Assuming that generators would also take the least costly course of action, we believe there is considerable merit in a more detailed review of this area as it would give a clearer indication of the economics of the network post a CAP170 implementation."</p> <p>"We would welcome greater discussion surrounding constraint management and SO incentives, and are disappointed that the current constraints problem was not foreseen and factored into previous incentive agreements, to address so that a solution could be considered in a more timely manner."</p>
Consumer Focus	<p>"Despite being supportive of CAP170, Consumer Focus does have reservations about the reduced timescales within which CAP170 has been progressed as an example of good governance, and there are clearly interactions with other changes in process (for instance, GB-ECM-18, proposing locational BSUoS charging). We also question why it has been cited by Ofgem only as an interim solution if, as is suggested, it could deliver steady-state benefits to consumers."</p> <p>"Consumer Focus shares some of the concerns on the urgent nature of CAP170 raised by responses to the NGET Consultation Document. However, we do take comfort from the fact that Ofgem has built a 6 week consultation window into the CAP170 timetable. We support the suggestions made in responses to the NGET Consultation Document that a working group should be set up immediately after the implementation of CAP170 (if approved) to allow more considered discussion and analysis of the issues raised."</p>
EDF Energy	<p>"A full CBA of the impacts of additional derogated boundaries should be conducted. In addition to the environmental impacts noted above this should quantify the impacts of new intertrip schemes. This analysis should not only consider National Grid's costs of such an arrangement, but should also pay regard to the costs incurred by different units including an assessment of the risk of trip and any subsequent disproportional impact on plant integrity and life. As this is considered to vary on a case by case basis, EDF energy would suggest that additional consideration should be given to any unforeseen Health and Safety impacts. "</p>

	<p>"EDF Energy would note that the current CBA data provided does not provide justification for the use of urgency for this proposal. Further, the discrepancies identified above and unforeseen interactions with other decisions could have been explored by a working group and a more robust solution developed."</p>
E.ON UK	<p>"Because of the urgent status accorded to CAP170, the documentation was released in a piecemeal fashion over some weeks. It was difficult to consider it all together in a holistic way."</p> <p>"As highlighted in our letter to NGET on 23rd March, many of the issues we raised have not been addressed by NGET. We assume this is because of the urgent timescales. We stress that we do not believe that CAP170 and its associated changes has had sufficiently robust scrutiny from industry."</p> <p>"It is notable that the changes proposed by CAP170 were not accorded the benefit of rigorous discussion in Working Groups, although they are considered sufficiently large to merit an Impact Assessment. It is difficult to understand the logic of a process which stifles debate. Any change introduced with so little time for consideration and consultation should be drafted as tightly as possible to address the exact difficulty perceived. This principle has not been followed in the preparation of CAP 170, and so E.ON UK cannot support it."</p>
RWE Power	<p>"Ofgem indicate that the CAP170 "is intended to be a short term measure" (Page 2). However, the proposed changes are permanent in the CUSC until such time as a further amendment proposal is raised to remove them from the CUSC. As such this is an enduring change and needs to be considered in this context. "</p>
Uskmouth Power	<p>"In conclusion, we do not feel that the proposal should be approved until the full details of the scheme have had proper consideration by the industry. In particular, it is vital that the industry have access to the methodology for deciding which generators are chosen, in order to ensure a fair process of selection is established. If, however, Ofgem were to agree to this modification we believe that they should ask NGET to review the associated costs and charging structures before implementation. "</p>

Part 3 - Summary of Industry Responses to Further Consultation

Party	Comments/Arguments
BWEA	<p>"At the very least there should now be a full and proper re-evaluation of CAP 076 payment terms and a transparent and open evaluation of all alternative options."</p> <p>"We also note that Ofgem had previously justified the truncated timeframes for CAP 170 by its urgency. The current consultation moves the goalposts by extending the assessment timeframe and stating the belief that CAP 170 will have long-term, if not immediate, benefits. BWEA would be surprised if there were not procedural / legal issues with this approach. Moreover, it is not justified. At the very least there should now be a full and proper re-evaluation of CAP 076 payment terms, and a transparent and open evaluation of all alternative options. "</p> <p>"We find it difficult to judge whether National Grid has or hasn't exhausted all the alternative, commercial possibilities for negotiating intertrip contracts. "</p>
Consumer Focus	<p>"In our original consultation response we raised some concerns about the urgent nature of CAP170. We are pleased that the urgent timetable has not precluded additional analysis and that the industry has been given a chance to respond to the updated figures that Ofgem has published. However, should CAP170 be approved and implemented, we would still support the suggestions made in responses to the National Grid Electricity Transmission (NGET) consultation that a working group should be set up to allow more considered discussion and further analysis of the issues raised."</p> <p>"However, we caveat our support with the concerns raised in our response to Ofgem's first consultation "</p>
Drax	<p>"Given the urgent status placed upon the proposal, there has been little engagement with industry to develop a mechanism that would address constraint costs whilst simultaneously promoting competition, thus better facilitating the CUSC objectives. A more appropriate action may have been for National Grid and Ofgem to engage with industry earlier, in order to develop a mechanism that provides an incentive to users to change their behaviour or to encourage users to provide a service via commercial arrangements; this could have helped to reduce constraint costs whilst <i>promoting</i> competition."</p>

Party	Comments/Arguments
EDF Energy	<p>"This second impact assessment has not recognised the concerns raised in our response to the first RIA. In particular that Ofgem has not identified and quantified impacts on sustainable development and has not addressed the other concerns raised. The proposed solution: will have negative impacts on consumers, competition and security of supply; is inconsistent with Government environmental objectives; and is unduly discriminatory "</p> <p>Classifying the modification as urgent prevented a "proper debate which would have allowed a more robust solution to be developed. Such a solution would not result in over-recovery by some plants and under-recovery for others. CAP 170 may also introduce perverse incentives on National Grid with regard to the selection of service providers."</p> <p>The arrangements proposed by DECC impact on any perceived benefits that CAP 170 may have. "...the Authority should either reject CAP 170 or defer a decision until the future access arrangements are better understood"..</p> <p>"As noted in the response provided to the first RIA, EDF Energy considers that the impacts of the decision on Interim Connect & Manage arrangements have not been adequately assessed or quantified. The likelihood of additional boundary derogations and the environmental impact of constraining low-carbon generation should be well understood before progressing with this proposal. "</p> <p>"Ofgem states in this RIA that CAP170 is expected to be an interim measure until enduring access arrangements have been put in place by the Secretary of State using his powers under the Energy Act. "</p>
E.ON UK	<p>"In our previous responses we have expressed our concern about the proposal, particularly as it has been raised and considered under the urgent amendment process."</p> <p>"Clearly, none of the above concerns are assuaged directly by the new cost information in the consultation."</p>

TABLE C – TIMETABLE ADOPTED FOR CAP170**Part 1 - CAP170 Timeline**

Process	Publication date	Response Deadline	Weeks	Working Days
National Grid				
NG Amendment raised and approved as urgent	27 February 2009	N/A		N/A
Ofgem Urgency Decision	2 March	N/A		N/A
NG Company Consultation (Urgent Process)	3 March 2009	13 March 2009	2 weeks	5 WDs
1 week				
NG Draft Amendment Report	18 March 2009	23 March 2009	0	3 WDs
CUSC Panel Vote (7-1 against)	23 March 2009	N/A		
Final Amendment Report	25 March	N/A		
8 weeks				
Ofgem				
Impact Assessment	21 May 2009	2 July 2009	6 weeks	30 WDs
3.2 weeks				
Further Impact Assessment	28 July 2009	25 August 2009	4 weeks	20 WDs
22 weeks				
Current Thinking and Competition Issues Consultation	26 January 2010	23 February 2010	4 weeks	20 WDs

Part 2 - CAP170 Ancillary consultations timeline

National Grid CAP170 Ancillary Consultations				
Grid Code: B/09 - Category 5 intertripping scheme				
Process ²	Publication date	Response Deadline	Weeks	Working Days
Consultation Document	3 March 2009	13 March 2009	2 weeks	10 WDs
Concerns over consultation process were raised at the Grid Code Review Panel and in various industry responses including: - AEP, Uskmouth Power, E.ON, RWE, British Energy and SSE.				
Procurement Guidelines³				
Consultation	12 March 2009	9 April 2009	4.1 weeks	21 WDs

² The Grid Code does not have a corresponding "Urgent Status" process.

³ Responses to the Procurement Guidelines were not published

Supplementary Consultation	1 April 2009	29 April 2009	4 weeks	20 WDs
Worked Examples and Response extension	24 April 2009	13 May 2009	2.5 weeks	13 WDs
Ofgem Licence Direction (Time limit waiver)	19 May 2009	N/A	N/A	N/A
Balancing Principles Statement⁴				
Consultation	1 April 2009	29 April 2009	4 weeks	20 WDs
Response Extension	24 April 2009	13 May 2009	3.4 weeks	13 WDs
Ofgem Licence Direction (Time limit waiver)	19 May 2009	N/A	N/A	N/A

⁴ Responses to the Balancing Principles Statement were not published

Part 3 - Timeline and Comparative Apportionment

