OFFICE OF
ELECTRICITY
REGULATION

REVIEWS OF PUBLIC ELECTRICITY SUPPLIERS 1998 TO 2000

CONSULTATION PAPER

FEBRUARY 1998

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FOREWORD

This consultation paper sets out the programme of work and reviews that I envisage for the 14 public electricity suppliers (PESs) over the next two years. It reflects my statutory duties, particularly to protect customers with respect to price, quality and continuity of supply and to promote competition. It is also designed to increase the effectiveness of regulation, and to increase the transparency of the industry's operation and regulation.

The programme has eight main components which have significant interrelationships between them.

1. **Distribution Price Control**

   An assessment of the operating costs, capital expenditure and required revenues of the distribution businesses, for implementation in April 2000.

2. **Quality of Supply Standards**

   A review of the standards and compensation payments on quality and restoration of supply in the light of the costs and capital expenditure involved.

3. **Competition in Supply**

   A consideration of whether to extend the price restraints on the PES supply businesses beyond April 2000, and if so in what form.

4. **Separation of Activities**

   A determination of the extent and nature of the steps necessary to achieve further and timely separation of PES activities, particularly with respect to distribution, metering and supply.

5. **Metering and Meter Reading**

   A consideration of how best to regulate these potentially competitive activities which are presently largely monopolies.

6. **Regulatory Accounts**

A review of the requirements on companies to prepare regulatory accounts and publish accounting information so as to increase transparency and improve regulatory effectiveness.

7. **Prepayment Meter Customers**

A review of the experience of these customers, the costs of provision and the implications for regulation.

8. **Scotland**

A review of those issues, additional to all the above which are common to all 14 PESs, which are particular to ScottishPower and Hydro-Electric, including the revision of their transmission price controls, the treatment of transmission with respect to separation issues, and the development of trading arrangements in Scotland.

These PES reviews will need to take account of the process and outcomes of other relevant reviews. These include the Government's review of utility regulation, where a Green Paper is due shortly; the Government's review of fuel sources for power stations due to be completed later in 1998; and the review of electricity trading arrangements, due for publication in July. The reviews will also need to take account of, and where relevant feed into, further developments during this period, including any proposals for legislation.

The processes for carrying out the PES reviews should be as transparent as possible, and all interested parties should have the opportunity to comment on an informed basis. I shall in particular seek the views of companies, customers and customer groups, and the Electricity Consumers' Committees. I shall want to consult at various stages of the reviews, and to publish relevant information. As in previous reviews I envisage appointing technical consultants for parts of the price control work, and a panel of senior advisers with extensive business experience.

It is also my intention to hold public hearings or seminars on some of the major issues. OFFER would welcome comments on the areas which these might cover, on possible format and participation, and on the stage at which they might usefully be held.

In view of the scope and interrelated nature of the work programme, it seems helpful at this stage to set out the main issues that I presently envisage the reviews covering, and the processes and timescales for dealing with them. These will need to be confirmed, developed and modified over time, in the light of events and experience. An outline timetable for the work areas described in this paper is attached as an Annex. It would be useful to have any initial comments on the programme set out in this paper. These comments should be sent by 13 March 1998 to:

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Responses will be published by placing them in the OFFER library.

PROFESSOR S C LITTLECHILD
Director General of Electricity Supply

11 February 1998

1 DISTRIBUTION PRICE CONTROLS

1.1 The original distribution business price controls were put in place by the Government before privatisation. They were set to run for five years from 1 April 1990. New price controls for the 12 regional electricity companies (RECs) in England and Wales were proposed in August 1994 and revised in July 1995. New price controls for the two Scottish companies were proposed in September 1994. Following a Monopolies and Mergers Commission (MMC) inquiry the proposals for Hydro-Electric were modified in October 1995. All these distribution price controls are due for further revision from 1 April 2000.

1.2 Revised distribution price controls will need to continue to ensure that customers are protected from monopoly power and benefit from achieved efficiency gains, while maintaining incentives on companies to make further efficiency gains during the new price control period. To set the revised controls, it will be necessary to examine a number of issues. Many of these have been discussed in previous reviews, but in most cases there are new dimensions in the light of experience. The issues include:

- what form the revised controls should take, and in particular whether they should continue to be based on an RPI-X constraint;
- whether a five year duration for the controls continues to be appropriate;
- whether any distribution revenue or services should be excluded from the price control;
- how energy efficiency considerations should best be accommodated, and in particular whether numbers of units distributed should continue to have a 50 per cent weighting in determining allowed revenue, and whether the incentives on companies to reduce distribution losses should be revised;
- whether any further measures are needed with respect to the environmental impact of electricity distribution or to promote sustainable development;
- what levels of operating costs are consistent with efficient operation, and in particular what productivity gains have been achieved in the present period and what scope there is for further gains, and how costs relate to the geographical features and organisational structures of the companies;
- what levels of capital expenditure are consistent with efficient operation and appropriate levels of security, and in particular how actual expenditure relates to the levels projected at the last review;

- what trade-offs exist between operational expenditure (for example, on maintenance), capital expenditure and quality of supply;

- what, if any, allowance should be made for changes to the standards governing reliability, quality and restoration of supply, bearing in mind their implications for costs and compensation payments, as discussed further in Chapter 2;

- how costs, assets and expenditure associated with metering and data management services should be treated, as discussed further in Chapter 5;

- the scope for increasing competition in the provision of connections to the distribution systems and how connection assets and charging should be treated under the price control;

- what return to existing assets is appropriate, and in particular whether Vesting assets should continue to be valued at flotation value uprated by 15 per cent, and at what rate assets should be remunerated over time;

- whether 7 per cent remains an appropriate cost of capital, including in the light of possible changes in gearing since takeover and in the corporation tax system;

- how much revenue companies require in the light of the above considerations and the relevance of financial ratios or other considerations in assessing this.

1.3 In view of the considerable extent of this work programme OFFER has already taken steps to prepare for the distribution price control review. It has asked the PESs for further details of their capital expenditure programmes to date, and is in course of analysing this. It is in discussion with the PESs to understand the development of their organisational structures and the changes over time in their operating costs.

2 QUALITY OF SUPPLY STANDARDS

2.1 The Director General is empowered to set Overall and Guaranteed Standards of Service for the PESs. Overall Standards are implemented by the Director General under section 40 of the Electricity Act and Guaranteed Standards are implemented by Statutory Instrument placed before Parliament by the Secretary of State. Network design standards are set in PES licences, and companies report annually on network performance. At the last price control review, requirements for companies to report annually on quality of supply improvements and capital expenditure were introduced.

2.2 In October 1997, OFFER issued a consultation paper proposing improvements to Overall and Guaranteed Standards, with particular reference to the distribution business activities of the PESs. In particular, it proposed that targets under a number of the Standards should be tightened and brought to a common minimum level for all PESs; and that there should be a new Guaranteed Standard covering prepayment meter faults. OFFER is presently considering comments on the proposals with a view to implementing changes. The paper also raised possible improvements to the Standards in relation to the restoration of supply, frequent supply interruptions and the scope for exemptions on account of severe weather, which will fall for consideration with the price control review. It will be necessary to consider whether further changes are necessary in the light of experience after the opening of the market to competition, and further developments with respect to metering and data management services, as discussed in Chapter 5.

2.3 Annual reports by OFFER on the performance of distribution networks show that in general quality of service has been maintained, and in some respects improved over the last few years. However, there are variations from one year to another from one company to another and from one area of each company to another. Annual quality of supply reports from companies have begun to shed more light on these differences, and the actions companies are taking to deal with them Experience of supply interruptions has led to questioning of the companies' policies and ability to respond in severe weather conditions.

2.4 The October 1997 consultation paper indicated that the forthcoming price control review would need to consider such matters, including possible improvements to the Standards with respect to distribution activities. Issues that will need to be explored include:

- the means of improving quality and reliability of supply, both in general and in particular areas;
- whether companies have met targets for quality of supply improvements;
- whether the present requirements for quality of supply reporting and target setting remain appropriate for the next price control period;

- the relative performance of refurbished and unrefurbished lines in severe weather conditions;

- the impact on the environment of network development and replacement;

- the scope for improved organisation and working arrangements and information flows, including from better network monitoring and communications facilities;

- the adequacy of communications with customers and the public, especially in severe weather conditions;

- the desirability of additional or more demanding Standards of Performance;

- the level and role of payments for breaching Guaranteed Standards;

- the costs of greater investment and improved procedures, the implications for the price control and prices to customers, and the preferences of customers on these matters.

3 COMPETITION IN SUPPLY

3.1 The original supply business price controls were put in place by the Government before privatisation. They applied to all the customers of the PESs’ supply businesses. Competition was scheduled to be introduced into the market on a phased basis from 1 April 1990, when customers with a maximum demand above 1 MW were allowed to choose a competitive supplier. From 1 April 1994 competition was extended to customers with a maximum demand above 100 kW. At that time the price controls were restricted to those customers with a maximum demand below 100 kW who could not yet take advantage of the competitive market.

3.2 The market was scheduled to be fully open to competition in 1998. It was recognised that it would take time for competition to be fully effective in the supply of electricity to all customers. It was also recognised that customers needed protection through a period of phased opening and controlled market start-up. The October 1997 price control proposals document set out maximum price restraints for 1998/99 and 1999/2000, to apply to smaller business and domestic customers while competition develops

3.3 In considering whether supply price restraints should continue for a further period, and if so in what form and for how long, it will be necessary to take account of the actual and prospective development of competition for domestic and small business customers. This will involve considering a number of factors, such as the market shares of different suppliers, the extent of actual and prospective entry into or exit from the supply business, the extent and level of competitive price offers, the margins earned by suppliers, the patterns of change over time, and any further evidence of competitive or anti-competitive behaviour. It will be relevant to look at evidence about the impact of competition on different groups of customers, and about the costs incurred by other supply businesses in serving those customers who might not be fully protected by competition, to whom any continued restraints might apply.

3.4 Setting any revised price control will involve considering a number of similar issues to those in the last price control review, informed by the experience of and prospects for competition, These issues include the following:

- whether it is appropriate to continue with maximum price restraints or to adopt some different form of price control;

- what is the appropriate duration for any further constraints;

- whether the scope of the control should be reduced with the development of competition - for example, to cover only domestic customers or particular classes of customers;

- whether it is appropriate to continue to support energy efficiency through Standards of Performance on public electricity suppliers, and if so how far this should impact on any price restraints;

- what impact changes in ownership, competition and the separation of businesses has had or might have on the level of costs and their allocation;

- what scope there is for further reductions in costs, or liability to cost increases, in future years;

- what considerations should be taken into account when setting the level of restraints - for example, evidence on margins of public electricity suppliers and of other suppliers and the likely effects of new entry and competition.

4 SEPARATION OF ACTIVITIES

4.1 Before Vesting, the Government reviewed the structure of the industry and made certain changes, particularly in England and Wales, to facilitate competition, regulation and flotation. It took the view that separation of transmission from generation was important to facilitate competition in generation and the regulation of the monopoly transmission network. The Government also considered the separation of distribution from supply. However at that stage, the nature and extent of prospective competition in supply could not be seen clearly, nor could the significance of such separation be assessed.

4.2 The Government decided that the PESs should continue to provide both the distribution and supply of electricity. It allowed them to continue other existing activities such as appliance. retailing and contracting, and allowed them to extend into new activities such as generation. It provided for four types of electricity licence, namely public electricity supply (covering distribution and supply within a PES authorised area), second tier supply (outside a PES area), generation, and transmission (relevant to the Scottish PESs). PESs were required to put distribution, supply, second tier supply and generation into separate businesses, to keep separate regulatory accounts for these businesses, and to publish the main elements of these accounts. Licence conditions provided that companies should publish their charges for use of the distribution system and for electricity supply, which were subject to separate distribution and supply price controls, and should not cross-subsidise nor unduly discriminate.

4.3 It is now timely to review these arrangements in the light of experience over the last eight years, and the likely requirements of customers, competition and regulation in the future.

4.4 Competition in supply has now become established for large and medium-sized business customers, and is in course of implementation for smaller business and domestic customers. The nature and needs of supply as a separate business activity have become more apparent. PESs are increasingly recognising that distribution and supply are quite different activities requiring different skills and strategies, which are not necessarily conducted most efficiently on the same scale or under the same ownership. Since 1994 competition has developed in the provision of metering to larger customers, as discussed in Chapter 5.

4.5 From a regulatory perspective, the importance of greater separation of PES activities such as distribution, metering and supply has become more apparent. For example, the allocation of costs as between activities, particularly differences in allocation as between English and Scottish PESs, has been an issue in setting price controls, often with significant implications for competition. Greater separation would be an advantage both in setting price controls and in promoting competition in generation and supply and other activities, including by reducing scope for cross-subsidy or discriminatory treatment which might favour one or other PES business activity at the expense of customers or competitors.

4.6 OFFER's evidence to the Government's review of utility regulation explained the advantage of separate licensing of distribution, metering and supply activities in bringing about this greater separation. This would require legislation. Issues for consideration over the next two years include the following:

- how or in what ways separation should be taken forward before or in parallel with any proposals to legislate;

- how the various PES activities should be grouped into separate businesses, and whether these separate businesses should be in separate companies, particularly with respect to distribution, metering and supply;

- how far operational separation between businesses should be required - for example, with respect to staff, locations and assets such as IT systems and sites;

- how far cost allocations of joint assets and services should be prescribed and on what basis;

- how far uniformity should be imposed on companies whose structure and scope may be increasingly different from each other;

- how responsibility for meeting Standards of Performance should be allocated between the separate businesses and revised where appropriate;

- what if any changes are appropriate in the structure of the use of system charges that PESs make to generators, suppliers and final customers to recover allowed revenues;

- how separate licensing might treat the various statutory and licence obligations of the PES - for example, which if any business should retain an obligation to supply, whether there would henceforth be a difference between the supply obligations of a PES and a second tier supplier, whether the concepts of tariffs and tariff customers would remain, how to ensure that the obligations of the distribution and supply licences can be discharged if they are in separate ownership, and so on;

- how far it is appropriate to encourage or require separate ownership, and by what means and over what timescale.

4.7 Where PESs have been taken over, the Director General has put in place a number of licence amendments intended to place a "financial ring fence" around permitted activities of the PES, as a safeguard against financial pressures which might undermine the PESs ability to continue to finance its functions, including investment in its distribution system. Among other things, the ring fence restricts the businesses which the PES can carry on, and regulates dealings between the PES and other companies (particularly other companies in the same group). The relevant licence conditions also require the licensee to secure that it has sufficient management and financial resources to carry on its PES business, and to give the Director General an annual certificate of the adequacy of its financial resources. In some cases, the licence conditions require the licensee to maintain an investment grade rating for its debt.

4.8 In his submission to the MMC in relation to the PacifiCorp bid for The Energy Group (Chapter 6 of the MMC's report), the Director General identified potential changes to strengthen the ring fence by inserting additional safeguards and removing from it substantially all activities other than supply and distribution. The MMC identified some further minor changes which might be made. The Director General intends to pursue both these sets of licence changes.

4.9 It will also be necessary to consider how the ring fencing provisions should apply in circumstances of greater separation of PES businesses. For example, it will be for consideration whether the ring fence should apply to all PESs or just those that have been taken over and whether it should be placed solely around the distribution business

5 METERING AND METER READING

5.1 The PES reviews will need to consider how metering, data collection and related activities are treated for regulatory purposes. In 1990 half-hourly metering was provided through the Pool by the local PES for 1 MW customers, Amendments to the Electricity Act clarified the ability of customers to provide their own meters, subject to the agreement of their supplier. From 1994 competition was introduced into the provision and maintenance of half-hourly metering equipment (meter operation) and customers of second tier suppliers in the 100 kW market were made responsible for arranging for the meter to be installed and maintained by appointing a meter operator to carry out these activities. In addition to PESs a number of independent meter operators entered the market to provide meter operator services to customers.

5.2 Since 1994, a single agent, UKDCS, has carried out data collection functions in the half hourly market on behalf of the Pool. Neither suppliers nor customers are able to collect their own data for Pool purposes.

5.3 In planning for supply competition in 1998 it was generally agreed that the existing arrangements needed reform. It was agreed that greater emphasis should be placed on the role of the supplier in ensuring that meter operator services are made available. From 1998 suppliers will have the primary responsibility for meter operation, data collection and the new function of data aggregation.

5.4 In the half-hourly market competition is bemg introduced into these activities, with suppliers free to choose who will provide the services. To smooth the introduction of competition in supply it was agreed that in respect of non half-hourly metered customers competition in these activities would be deferred until April 2000. To ensure that these services are made available to all suppliers PESs are required to provide these services on a non-discriminatory basis.

5.5 The 1994 distribution price control proposals indicated that it might be necessary to reconsider the arrangements relating to metering before the price control is scheduled for revision on 1 April 2000. In 1998 the PESs will provide new services to suppliers to facilitate competition. In addition to meter operation, data collection and data aggregation, PESs will also provide metering point administration and prepayment meter systems. Collectively these are known as the Data Management Services. In October 1997 the Director General made a proposal to modify the distribution price control to allow the PESs to recover an allowance for the set up and operating costs associated with data management services. The proposal provided for set up costs to be recovered over a period ending in April 2003 together with an annual allowance for operating costs.

5.6 At present the data management services are, with the exception of the prepayment meter infrastructure, all treated as part of the distribution business for purposes of separate accounts and price control. If the services are moved out of distribution for regulatory purposes then it will be necessary to consider whether the PESs should continue to be obliged to provide these services to suppliers on request. The PES reviews will need to consider whether the data management services that are opened to competition in 2000 need to continue to be subject to controls and if so what form those controls should take both in relation to the end price to customers and charges to second tier suppliers. In addition to considering the level of appropriate charges, it will also be important to consider whether the charging structures for these services are conducive to competition in the provision of the services themselves and to ensure that they do not distort competition in supply.

5.7 These issues will be influenced by the overall extent of separation between distribution and supply functions. Changes to arrangements for metering and meter reading will also need to take into account the opportunities for technical innovation, New metering and communication systems are likely to have an important role in the supply market. They may also give rise to efficiency and service improvements in the distribution of electricity. It will be for consideration how such innovation can be encouraged and how the various potential benefits and costs should best be shared.

6 REGULATORY ACCOUNTS

6.1 PESs are required by their licences to keep regulatory accounts for their separate businesses, to send them to the Director General and to publish some but not all of the information in these accounts. It was envisaged at Vesting that such accounts would be helpful as a means of understanding and regulating the companies. In practice, the usefulness of the regulatory accounts has been limited. The Director General can obtain information he requires from the companies, in whatever detail and extent is required for a particular purpose. To the outside observer, however, the published accounts reveal relatively little, and the relationship of the regulatory accounts to the companies' statutory accounts is unclear. Regulatory accounts have in some cases not reflected the ways in which the PESs actually run their companies, which have in any case changed over time and in many respects have become increasingly different from one company to another. There is guidance to companies as to the way the accounts should be prepared, the detailed implementation of which may be open to interpretation and this raises the possibility of significant differences between companies as to the accounting policies used.

6.2 PES organisational structures and accounting procedures initially reflected the experience and thinking of the previous nationalised industry and the decisions made at Vesting. It was important that changes should be made to reflect the needs of a competitive privatised industry. But these could not be predicted in advance. It now seems appropriate to review developments and experience over the past eight years, and to consider what form regulatory accounts should take in future.

6.3 Regulatory accounts can potentially provide information about the financial performance of the regulated components of the PES businesses that can be used to inform regulatory action and evaluation by others. This could include such matters as costs and revenues, cost allocation, financial stability, compliance with ring fencing requirements, enforcement of licence conditions prohibiting price discrimination and cross-subsidy, setting the price controls, analysis of potential mergers, and other policy issues.

6.4 With this in mind, issues to be covered in the review will include the following:

- which businesses of electricity licensees should be required to prepare regulatory accounts, taking account amongst other things of conclusions on the greater separation of PES businesses;
- the scope for publication of more regulatory accounting information;
- how far and in what area there is a case for detailed standardisation across all companies, for example, with respect to rules for transfer pricing and cost allocation as between different businesses;

- how far and in what areas it is preferable to allow flexibility, and how to deal with differences between companies in organisation and management accounting;

- what implications for regulatory accounting arise where PESs contract out significant functions, such as billing, customer service or maintenance, to other companies in the same group;

- whether the basis of asset valuation should be specified, and if so whether it should be historic cost, current cost, or the "regulatory asset valuation" (linked to values used in price control reviews);

- whether changes should be made to make clearer the relationship between PES regulatory accounts and the assumptions (about, for example, costs and capital investment) on which the new price controls are based;

- the extent to which PESs should provide narrative explanations of significant year-on-year changes;

- timeliness of provision, including the possibility of combining regulatory accounts with other information provided to OFFER.

7 PREPAYMENT METER CUSTOMERS

7.1 The use of prepayment meters has increased in recent years. On average, about 15 per cent of domestic customers now take supply on this basis. The proportion differs from one company to another, ranging from about 10 to 23 per cent.

7.2 The recent customers' survey conducted for OFFER by MORI found that 82 per cent of prepayment meter customers were either totally or very satisfied with prepayment meters as a method of paying for electricity. This suggests that prepayment meter customers are relatively content with present arrangements.

7.3 Customer representative groups have nonetheless expressed concerns about the surcharge generally made for electricity under prepayment meter arrangements, on the grounds that this hits hardest that sector of the population least able to pay more. In practice, there is only a limited relationship between income levels and the use of prepayment meters. Evidence from the MORI survey suggests that in round terms, about half prepayment meter customers are "low income" customers (defined as a respondent in receipt of Income Support or Family Credit), and about half low income customers have prepayment meters. Nonetheless, this is an issue which needs examination and careful consideration and may require further action.

7.4 The review will cover three main areas. First, as part of the assessment which the Minister for Science, Energy and Industry has requested into the way in which the liberalised market operates to the benefit or detriment of different classes of customers, OFFER will examine in particular how prepayment meter customers have initially fared as the market is opened up to competition. This will include monitoring the prices charged to such customers, together with any additional terms, by comparison with other customer groups.

7.5 Second, as explained in the Director General's proposals in October 1997 on supply price restraints, there will be a systematic examination of all the costs of prepayment meter services. This will include the costs of the meters themselves, the infrastructure for accepting payment, and the various costs of billing, meter reading, customers service, maintenance, debt collection, and so on. Some of these costs are incurred by the PES supply business. It will be necessary to compare costs across PESs, which have different technologies and policies, and cost allocation between customer groups will also be important

7.6 The third area is to consider the policy implications. This includes the appropriate charges to PES customers, and to other suppliers. A number of considerations will be relevant, including the desirability of all customers benefiting from competition, particularly the lowest income groups; the implications of different charging arrangements for the development of competition for these customers; and the longer term effects on efficiency and innovation.

8 SCOTLAND

8.1 All the above issues apply equally to the two Scottish PESs as to the 12 PESs in England and Wales. However, there are different features of the industry structure in Scotland which raise additional issues.

8.2 The two Scottish companies are both vertically integrated. Between them, they account for about 60 per cent of Scottish generation, and they are contracted to take the remaining 40 per cent from Scottish Nuclear until the year 2000.

8.3 The Scottish companies also own and operate the high voltage transmission system in Scotland. Each has common management of transmission and distribution under a power systems division. There is no Pool in Scotland and the Scottish companies jointly schedule their own plant and control the grid.

8.4 The extent of competition in generation and supply in Scotland is less than in England and Wales, as measured by market concentration and changes in market shares. Prices to customers have been held to a level broadly comparable with those in England and Wales. This is mainly as a result of a Scottish supply price control based on generation prices paid by RECs in England and Wales, and obligations on the Scottish PESs to make electricity available to other suppliers at a Pool related price. Whether this is a satisfactory arrangement for the longer term will need consideration in due course. Two main issues will be covered in the present programme of reviews.

8.5 First, there is the review of the Scottish transmission price control. The initial controls were set by the Government at Vesting for a period of four years. They were revised in 1994 for a further five years, and are due for revision from April 1999. However, it will be more sensible to review this control in parallel with the reviews of the distribution and supply price controls, which are due for revision from April 2000. This will allow proper examination of the common management of transmission and distribution activities, and the allocation of costs across all the businesses. OFFER has consulted on how to control Scottish transmission charges in I999/2000.

8.6 The full transmission price control review will include an examination of all the issues covered in the previous transmission price control. In many respects these are analogous to the issues in the distribution price control review as set out above - including, for example, the form and duration of the control, treatment of energy efficiency, assessment of efficient operating costs and capital expenditure, cost of capital and required revenue stream, asset valuation and asset lives, structure of charges, and so on.

8.7 Second, there are the trading arrangements in Scotland. Under the existing arrangements the Scottish PESs are required to make electricity available to any second tier supplier requesting it and to purchase excess generation “spilled’ onto the system by independent generators. From 1 April 1998 the Scottish wholesale price (which will be charged for purchases by second tier suppliers) will be set equal to Pool selling price, as presently defined, plus transmission services Uplift, less a discount of one per cent to reflect the lower incidence of constraints in Scotland. From the same date, independent generators will be paid for "spill" at Pool purchase price for the first tranche of market spill, equivalent to 10 per cent of second tier demand, and at a lower rate above this level.

8.8 The review will need to consider further change in the light of concerns expressed by customers, second-tier suppliers and potential combined heat and power (CHP) operators and independent generators that the arrangements are unduly favourable to the two integrated Scottish companies. Issues which will need to be considered include wholesale price-setting and spill arrangements in Scotland, possible modifications to the operation of the arrangements for scheduling and despatching generating plant, the effective separation of the businesses of the Scottish PESs and charges in respect of constraints on the Scottish transmission system. It will also be necessary to consider options for future trading arrangements in Scotland, including the possibility of bringing Scotland within the scope of GB-wide trading arrangements, in the light of the conclusions of the review of electricity trading arrangements in England and Wales.

ANNEX - OUTLINE TIMETABLE

1998	March	Consultation paper on separation of PES busmesses.
	April	Consultation paper on regulatory accounts. Consultation papers on key issues for price control reviews covering distribution, metering and supply; transmission price control in Scotland; and quality of supply standards.
	June	Business plan questionnaires sent to PESs, covering distribution, metering and supply and transmission in Scotland.
	July	Further consultation paper on separation of businesses.
	September	Consultation paper on Scottish trading arrangements. Outline proposals on separation of businesses Further consultation on regulatory accounts. PESs return business plan questionnaires.
	Winter	Further consultation paper on Scottish trading arrangements. Consultation paper summarising information in PES business plans.
1999	Spring	Consultation paper on setting out the Director General's position on key issues relating to revised price controls and quality of supply standards. Detailed proposals on separation of busmesses; initial assessment of the impact of the competitive supply market on different customer groups. Proposals on Scottish trading arrangements.

	Summer	Publication of draft proposals for price controls and Standards of Performance. Final proposals for price controls and quality of supply standards.
2000	April	Revised price controls, quality of supply standards and regulatory accounting arrangements to take effect.