



## **Response by SP Transmission Limited to Ofgem/DTI's August 2003**

### **Consultations on Transmission Charging and the**

### **GB Wholesale Electricity Market**

#### **1. Executive Summary**

SP Transmission Limited (SPT) welcomes the opportunity to respond to these consultations on transmission charging within a GB wholesale electricity market. Although it is intended that SPT as a “non-affiliated TO” should not have direct responsibility for transmission charging, SPT considers that it still has a significant and relevant interest in ensuring that there is an appropriate GB-wide transmission charging structure. SPT also believes that Ofgem/DTI must take into full account the recent Government energy review and ensure that there is a transmission charging structure that promotes security of supply and renewable generation capacity throughout GB.

SPT would make the following key points:

- Each Transmission Licensee has a special and legitimate interest in charging. This is because charging will impact on their ability to discharge their wider regulatory obligations, (e.g. planning and developing their transmission systems). This is also because charging could influence the extent of investment in their networks. Any changes to charging may lead to inefficiencies in investment planning. SPT and Scottish Hydro-Electric Transmission Limited, (SHETL), should have a clear role in the change process to the GB transmission charging methodology.
- SPT has achieved a level of stability and security in transmission charging and has provided a stable framework for customers. There should be no sudden change to that framework. Rather, it is in the best interests of customers that any changes are phased in appropriately. Any changes must not jeopardise



SPT's ability to comply with its current and future obligations regarding system security.

- Charging reforms must not prejudice competition between transmission licensees. This would be against customers' interests. The GBSO's central role gives rise for concern in this area. The central role of a GBSO with an affiliated TO business creates scope for discrimination against non-affiliated TOs. It also creates scope for adverse manipulation of the prices of connections. The scope for such discrimination must be minimised by strong regulation. Regulation of the interface between the GBSO and its affiliate TO business by way of appropriate separation, backed up with provisions that prohibit discrimination by the GBSO in favour of its affiliate TO business is necessary.
- It is noted that the GBSO designate is to lead much of the work on the development of GB- wide charging. This may be sensible and practical. However the GBSO designate is not subject to any regulation in respect of such matters. Clarification is required of the framework and criteria that will govern the GBSO's activities and the judgements it makes in this regard.
- The proposed approach to GB-wide transmission charging arrangements must be designed to facilitate Government energy policy and in particular encourage investment in renewable generation capacity. SPT recommends further discussions in order to identify the effect that transmission charging has on renewable energy investment decisions.
- Decisions on the treatment of 132kV connected small generators under BETTA are a prerequisite to progress on GB transmission charging. There should be no further delay on consultation on this critical matter.
- Article 7(6) of the Renewables Directive requires, in general, that the charging of transmission and distribution fees does not discriminate against electricity from renewable energy sources. Accordingly a full review of all such matters as apply to renewable generators is required to ensure that all such aspects meet the criterion set out in that article.



- SPT would also welcome further discussion of the proposed interpretation of the second part of the Article 7(6), in particular the interpretation of “peripheral regions”. The proposed interpretation is potentially too restrictive, as whether an area is of “low population density” is only one example of what can constitute a “peripheral region”. Although SPT recognises that defining “peripheral” is not an easy matter, factors such as distance from population centre and existing infrastructure may be an important part of such definition.
- The suggested discount for “peripheral” transmission connected generators should be reviewed.



## **2. General Comments on Transmission Charging Reform in Scotland**

SPT has a significant interest in ensuring that there is an appropriate GB-wide transmission charging structure. This is for two key reasons.

First, although SPT will no longer be responsible for setting transmission charges, SPT will continue to have licence obligations. The charging regime will impact on the ability of SPT to discharge those licence obligations. As an example SPT will have an obligation to promote the security and efficiency of the electricity generation, transmission and distribution systems each taken as a whole. The design of charging structures is an essential element in promoting the security and efficiency in these systems.

Unlike in England and Wales, there have been no major transmission charging reforms since Vesting. Consequently SPT's customers have benefited from stability and continuity in their transmission charges. This certainty in charging has helped SPT to promote a stable and secure network.

SPT requests that Ofgem/DTI take proper account of the impact of introducing E&W transmission charging arrangements GB-wide on its ability to discharge its licence obligations, both present and future. It is important that changes in charges do not force users to take significant business decisions such as premature closure of generation plant if such actions could result in serious consequences e.g. regarding system security.

Secondly, the methodology employed in setting charges and the quantum of charges will be a key part in securing that each transmission licensee's business continues to attract an appropriate level of investment. Clearly a transmission charging structure that actively discourages connections to a transmission licensee's network would have an impact on that business' sustainability.

### **3. Comments on Chapter 5 - Proposed framework for charging to support a competitive GB wholesale market**

#### **3.1 Framework**

SPT has discussed the Ofgem/DTI views on the appropriate relationships between Users, the TOs and the GBSO in its responses to the consultations on the STC and the CUSC. Accordingly it does not discuss such matters further in this context.

SPT would welcome clarification of the statement at paragraph 5.5 that *“The GB system operator in its capacity as connection services provider of the last resort would also be the contractual counter party for users who choose not to procure contestable elements of connection from an independent third party.”* This statement is misleading. Only TOs will be able to provide a connection to transmission networks in GB. Ofgem/DTI’s current thinking is that the GBSO would be the counterparty to a contract which offers those services but the GBSO is not a connection provider of last resort. This is an expression which is used in an electricity distribution context and is wholly inappropriate here.

SPT accepts that the responsibility for use of system charging should be allocated to the GBSO. However as SPT explained in its response to the recent Ofgem/DTI consultation “Regulatory Framework for Transmission Licensees Under BETTA”, SPT does have concerns about the role of the GBSO in charging for connections. Part of that SPT response is set out at Appendix 1 for ease of reference.

SPT agrees that charging methodologies for connections must, to some extent, be harmonised. However the extent of any harmonisation must be considered carefully. Over harmonisation may lead to a situation where competition between all transmission licensees for connection customers is blunted. That would not be in customers’ interests and may sit ill with the Authority’s primary statutory duty.

### **3.2 A model based on NGC's current licence obligations**

SPT agrees that the current NGC licence conditions form a basis on which to commence consultation. However Ofgem/DTI is correct to identify that these conditions will require to be reviewed.

### **3.3 Other potential refinements**

#### ***Consistent treatment of internal and external GBSO costs***

SPT agrees with the Ofgem/DTI conclusion at paragraph 5.22. SPT endorses the need for appropriate treatment of TO and GBSO costs in the context of a vertically integrated TO and GBSO. That conclusion infers a requirement for clear regulation of the relationship between the GBSO and its affiliated TO business. An element of separation is required to monitor these different costs.

In the SPT response to the recent consultation "Regulatory Framework for Transmission Licensees Under BETTA", SPT commented in some detail on the scope for abusive behaviour by an integrated TO/GBSO and the need for enduring regulation to minimise the scope for such abuse, such as non discrimination provisions. SPT continues to stress that with NGC acting as both TO and GBSO without any legal separation, there is the potential for the GBSO to favour its affiliated TO business

Ofgem/DTI suggests options to make NGC as GBSO treat all TOs on a non-discriminatory basis. As a minimum, there must be an amendment to NGC's relevant objectives under its licence to ensure that all TOs are treated on a non-discriminatory basis.

As SPT has explained in its response to the Ofgem/DTI consultation "Regulatory Framework for Transmission Licensees Under BETTA", regulatory separation within NGC is required for BETTA. Without such separation how can compliance with anti-discrimination measures can be effectively assessed and enforced?

As already noted, SPT also believes that non-affiliated TOs should be fully involved in the change process for the GB transmission charging methodology.

### ***Non- discrimination and TOs***

Under the present E&W arrangements, NGC manages the charging review process and takes decisions, approved by Ofgem, with reference to their “relevant objectives” under their licence. In managing this process, NGC goes through the process of considering all user comments on a broadly equivalent basis.

SPT is concerned that this process, if carried out by a combined GBSO/TO, would give insufficient weight to a non-affiliated TO’s legitimate interests (discussed above) in system security and promoting network investment. One way to mitigate this concern is for non-affiliated TOs to have an influential role in the change process for changes to the GB transmission charging methodology. SPT has also already expressed concerns at the ability of the GBSO to give its affiliated TO’s views undue weight.

Under the change process, the views and requirements of Scottish TOs should be given sufficient weight, in line with their key role under BETTA.

As a minimum the GBSO must be under a licence duty to have regard to the interests of each TO. Additionally, it should be under a licence obligation to treat its affiliated TO in exactly the same way as it treats any other TO. Each TO should be able to stop publication of any statement by the GBSO, which misstates or is otherwise inaccurate as regards the position as regards that TO’s business or operations.

The charging objectives for the GBSO must take into account the TOs’ regulatory duties and facilitate the TOs’ ability to discharge those obligations.



## **4. Comments on Chapter 6 – Implementing a GB charging regime**

### **4.1 Basis of consultation**

SPT agrees that the current charging in England and Wales can form a basis for consultation on GB wide charging.

### **4.2 Process and timetable**

SPT notes that initial responsibility for consultation on charging is to be passed on to the proposed GBSO. However, at present, the GBSO designate is not subject to any regulation in that capacity. Accordingly SPT would welcome clarification of the framework which will govern the GBSO's unregulated activities in this regard and the criteria that will constrain the GBSO's discretion in carrying out the consultation and coming to its conclusions.

In this section Ofgem/DTI is correct to concentrate on certainty for Users. This, (as SPT has explained) has an impact on SPT's ability to discharge its licence obligations. SPT is concerned that Ofgem/DTI's approach to move to GB-wide charging based on the E&W transmission charging methodology will, if not adjusted in some way, fail to recognise the material impact on some companies.

In the mid 1990's NGC phased in the implementation of locational use of system charges over a five year period. This phasing was a necessary requirement in light of the considerable material impact faced by users in E&W. SPT believes that it is both necessary and reasonable to phase in any significant changes in charges and that without phasing there is the potential for existing users to take business decisions that will impact on the security of the Scottish transmission system.

SPT urges Ofgem/DTI to seriously consider making provision in the GBSO's licence to require the phasing in of charges.





## **5. Comments on Chapter 7 - Transmission charging and renewables**

### **5.1 Introduction**

#### ***Cost-Reflective Transmission Charging***

The consultations place considerable emphasis on GB-wide transmission charges being “cost-reflective”. SPT agrees that transmission charges should be cost-reflective but questions whether locational TNUoS charges meet this criterion. It is also important to note that transmission charges should be stable and ensure the equitable allocation of costs between users.

Although there is a case for marginal cost type charging in a competitive market, the justification for marginal cost type charging in a monopoly transmission network with large sunk costs is open to question. The setting of transmission charges is a complex matter that requires the person formulating the charges to weigh up a variety of matters.

The use of marginal cost pricing must be weighed up against the importance of providing generation and load customers with a stable framework of charges against which they can take the long - term investment decisions that significant capital projects require.

The setting of charges must also take into account the wider public good that arises from network investment, as a result, for example, of increases in the security of the total GB network and the promotion of renewable generation.

Charges must also take into account the key TO obligation to plan and develop a safe and secure system. That implies, for example, that a region must have a sufficiently stable network that is not reliant on excessive transfers of electricity from other regions within the total system. Charges should take into account potential changes in generation type and capacity over the medium and long term and other matters that would be taken into account as part of the professional engineering and commercial judgements made in planning transmission networks.

### ***Differing Scottish Requirements***

It is relevant to consider that NGC's locational transmission charging arrangements were developed in the mid 1990's to meet conditions in England and Wales. At the time it was decided that due to the material impact on users, these new charging arrangements should be phased in over a five year period.

The rationale for the change was to give more weight to geographic factors with excess demand in the south of England and excess generation capacity in the midlands and north of England. It is notable that locational transmission charging in E&W does not appear to have had any impact on the disposition of generation and demand in E&W.

By adding Scotland to create a GB-wide use of system charging regime, the charging network over GB becomes far more complex. Considerable Scottish demand and generation capacity will be located north of the northern generation in England. Other complicating factors include a near doubling of the length of the transmission system, the anticipated inclusion of Scottish 132kV assets, and the inclusion of two additional transmission systems with different planning and security standards.

## **5.2 Legal issues**

Care should be taken in the general approach to be adopted with regard to charging. Of particular importance is the balancing of the different drivers reflected in the EU directives concerning renewable generation and transmission charging. A holistic approach that recognises these and other government policies is a prerequisite to achieving a sustainable transmission charging model. To proceed without proper regard to renewable generation will, given the continued emphasis on the importance of such generation in the long term, at all levels of government will inevitably lead to irreconcilable tensions in the market which can only be addressed by further significant changes. It must be more efficient to recognise these tensions and address them from the outset.



In reaching a view on appropriate GB-wide charging it is important that full consideration is given to responses to the forthcoming consultation on small generators. In particular, it is essential that the treatment of 132kV connected small generators under BETTA is resolved.

Article 7(6) of the renewables directive requires, in general, that the charging of transmission and distribution fees does not discriminate against electricity from renewable energy sources. Accordingly a full review of all such matters as apply to renewable generators is required to ensure that all such aspects meet the criterion set out in that article.

SPT would also welcome further discussion of the proposed interpretation of the second part of Article 7(6), in particular the interpretation of “peripheral regions”. The proposed interpretation is potentially too restrictive, as whether an area is of “low population density” is only an example of what can constitute a “peripheral region”. Although SPT recognises that defining “peripheral” is not an easy matter, factors such as distance from population centre and existing infrastructure may be an important part of such definition.

The proposed GB-wide transmission charging arrangements may not facilitate Government energy policy and in particular may discourage investment in renewable generation capacity. SPT recommends further discussions in order to identify the effect that transmission charging has on renewable energy investment decisions.

**SP Transmission Limited**

**3 October 2003**

**APPENDIX 1 – EXCERPT FROM SPT DOCUMENT DATED 22 SEPTEMBER 2003 ENTITLED “RESPONSE TO OFGEM CONSULTATION PAPER “REGULATORY FRAMEWORK FOR TRANSMISSION LICENSEES UNDER BETTA JUNE 2003”**

***Pricing information***

In some situations it is especially important to ring fence and regulate information flows. Customers’ rights to competition must be safeguarded.

Currently if an applicant requests connection offers from each of the Transmission Licensees it will get three offers. No Transmission Licensee has sight of the others’ offers. Accordingly no Transmission Licensee has the opportunity to inflate his price to a level close to the next lowest offer, thus blunting the effects of competition.

The current proposal that the GBSO will make all connection offers creates the risk that the GBSO will disclose the price of a Scottish TO’s offer to its own TO business. This may harm customers. By way of example this would enable the GBSO’s TO to increase its price to a level that is close to the next lowest offer.

As well as harming customers this could harm the Scottish TOs. If a Scottish TO’s offer was below the GBSO’s TO business’ planned offer the GBSO’s TO could lower its offer if information about the Scottish TO’s offer was provided to it by the GBSO.

A connection offer is likely to comprise TO costs and GBSO administrative costs. The GBSO component must be separately identified. It must be justifiable and cost reflective. Otherwise the GBSO will be in a position to favour its affiliated TO business by increasing the “mark up” on offers in respect of connections to other transmission networks. Again SP Transmission would note that the potential for such conduct is harmful not only to TOs, but is also harmful to customers, as it is a fetter on competition.



The potential for such behaviour can only undermine confidence in the competitiveness of the connections market. In order to secure that confidence remains regulation of the offer process is required.

Specifically the scope for GBSO/TO collusion must be regulated at licence level and provision must be made for independent audit. Offers should be provided to applicants without any disclosure of pricing or design information received from the Scottish TOs to the GBSO's TO business.

Applicants may wish to receive information on connection costs directly from the Scottish TOs. As with balancing services, it is difficult to see how the TOs and their customers can be said to be treated fairly and operate on a level playing field if the GBSO's affiliated TO business is privy to greater information than the others. Separation and restriction of information flows between the GBSO and its affiliated TO are necessary if a fair and level playing field is to be achieved. SP Transmission invites Ofgem to explain how proper regulation and the promotion of competition will be possible, absent such separation.