

Credit Cover for Transmission Owners

An Ofgem Consultation Paper

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Summary

Under BETTA, users in Scotland will cease to contract with Scottish Hydroelectric Ltd. (“SHETL”) and SP Transmission Ltd. (“SPT”) for connection to and use of their respective transmission systems, and will contract with the National Grid Company plc (“NGC”) instead. NGC will contract with SHETL and SPT, as transmission owners, for the provision to it of transmission services in Scotland under the System Operator – Transmission Owner Code or “STC”.

Although NGC will bear the credit risk of users to which SPT and SHETL are currently exposed, SPT and SHETL will still be exposed to the risk that NGC may be unable to make payment to the transmission owners. Given that under BETTA the revenues of the transmission owners come almost exclusively from NGC, the consequences of default by NGC are more severe compared to the default of any one user today.

The arrangements, both existing and being introduced by the Energy Act (2004), that are intended to safeguard the financial integrity of transmission licence holders, including NGC, and to secure the operations of the licence holders in the event of insolvency, are discussed, and it is suggested that the likelihood that transmission owners would not be paid is low. Nevertheless, recognising that the consequences for transmission owners of non-payment could be severe, options are considered whereby ongoing payment to transmission owners might be ensured. It is suggested that some of these options may be vulnerable to legal challenge, whilst there are possible efficiency concerns with cash or letters of credit. A ‘payment trust proposal’ is also described. Were this option to be pursued further work would be required to determine its robustness. It is also suggested that either making the provision by transmission owners of transmission services conditional on being paid or the threat of enforcement action might also mitigate the risk of non-payment.

It is noted that there is a degree of credit risk for the transmission licensees today. Recognising this, together with the requirement that any change be necessary or expedient for the implementation of BETTA, views are invited as to whether the risk of non-payment warrants the direction by the Authority of amendments to the STC and CUSC under transitional powers. It is noted also that the STC Parties are able to propose an amendment, which the Authority could consider under the enduring STC amendment arrangements.

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1. Introduction

- 1.1. Under BETTA, users in Scotland will cease to contract with Scottish Hydroelectric Ltd. (“SHETL”) and SP Transmission Ltd. (“SPT”) for connection to and use of their respective transmission systems. Instead, users will contract with the National Grid Company plc (“NGC”) for connection to and use of the GB transmission system, and NGC will contract with SHETL and SPT, as transmission owners, for the provision to it of transmission services in Scotland under the System Operator – Transmission Owner Code or “STC”.
- 1.2. Although NGC will bear the credit risk of (i.e. the possibility of non-payment by) users to which SPT and SHETL are currently exposed, SPT and SHETL will still be exposed to the risk that, irrespective of the creditworthiness of users, NGC may be unable to make payment to the transmission owners. Given that under BETTA the revenues of the transmission owners come almost exclusively from NGC, whereas currently the transmission owners receive revenues from a number of users, the consequences of default by NGC are more severe compared to the default of any one user today.
- 1.3. There are arrangements, both existing and being introduced by the Energy Act (2004), that are intended to safeguard the financial integrity of transmission licence holders, including NGC, and to secure the operations of the licence holders in the event of insolvency. Nevertheless, despite these arrangements, there exists the possibility of non-payment by NGC, which is a risk to which the transmission owners will be exposed.
- 1.4. This paper consults on the need for and possible nature of arrangements to secure payments to transmission owners in the event of NGC default.

2. Timetable

- 2.1. Respondents are invited to comment on the proposal covered in this paper. Each response will be published on the Ofgem website and held electronically in Ofgem's Research and Information Centre, unless there is good reason why it must remain confidential. Respondents are asked to put any confidential material in appendices, such that the main body of the response can still be published.
- 2.2. Responses, marked "Credit Cover for Transmission Owners consultation", should be sent by 10 January 2005. Ofgem would prefer responses to be sent by email to BETTA.consultationresponse@ofgem.gov.uk, but responses can also be posted to:

David Haldearn
BETTA Project
Office of Gas and Electricity Markets
9 Millbank
London
SW1P 3GE

- 2.3. Ofgem will consider all responses received and intends to publish a report on these responses and the conclusions drawn early in the new year.
- 2.4. If you wish to discuss any aspect of this document, please contact Richard Haigh by emailing Richard.Haigh@ofgem.gov.uk, or telephoning 020 7901 7487.

3. Background

- 3.1. Between 26 August and 1 September 2004, changes to the transmission licences of NGC, SPT and SHETL designated by the Secretary of State took effect. The Secretary of State also directed NGC to make certain amendments to the CUSC, and designated the new STC.
- 3.2. The effect of these changes is to extend NGC's responsibility for providing connection to and use of system from England & Wales to all of Great Britain. SPT and SHETL cease to have this responsibility within what used to be their Authorised Areas and, instead, provide "transmission services" to NGC under the terms of their respective licences and the STC.

Previous BETTA Consultations

- 3.3. Ofgem/DTI consulted on the STC first in December 2002¹, and again in June 2003². The June 2003 document stated that Ofgem had already consulted and concluded upon credit cover arrangements generally for network operators³, who include transmission owners. The presumption was that network operators should employ commercial best practice in the management of credit risk. Industry working groups were being set up in order to establish what constitutes best practice, following which Ofgem intended to publish best practice guidelines such that the pass through of bad debt would be considered providing that these guidelines had been followed.
- 3.4. Ofgem/DTI thus proposed that the STC should not contain any specific provisions for credit cover in respect of GB system operator payments to the transmission owners, but that if as a result of the industry working group

¹ "Regulatory framework for transmission licensees under BETTA, Volume 3: The SO – TO Code and other contractual interfaces between transmission licensees. An Ofgem/DTI consultation", December 2002, 88/02 Vol 3.

² "The SO-TO Code under BETTA: Summary of responses and conclusions on Volumes 3 and 4 of the December 2002 consultation on the regulatory framework for transmission licensees under BETTA, and further consultation on content of the SO-TO Code." , June 2003

³ See Section 3.9 below.

deliberations, modifications to the STC were warranted, then these could be proposed at the appropriate time. Ofgem/DTI further concluded that, until any such amendment were made, the pass through of bad debt by a transmission owner from a defaulting GB system operator to a successor GB system operator would be determined by Ofgem on the basis that it currently makes such decisions, taking into account whether the transmission owner had prudently managed its credit risk, given the arrangements set out in the STC as it then existed.

3.5. One response, from SPT, expressed concern that the credit arrangements proposed by Ofgem/DTI would leave transmission owners exposed to payment default by the GB system operator. It suggested that other models be considered including:

- the lodging of credit cover with transmission owners
- the provision of transmission owner rights over GB CUSC revenues or NGC property, and
- insolvency insurance with beneficial interest lying with transmission owners.

3.6. SPT stated that it favoured a further option, that it described as the “EPFAL solution” which would be akin to the payment clearance arrangements employed under the former Pool arrangements, whereby a separate not-for-profit company be established to collect payments under the GB CUSC and to forward payment to transmission owners.

3.7. Ofgem/DTI published a further document on the STC in April 2004⁴. In this document, Ofgem/DTI noted the views that argued some form of credit arrangements should be considered in respect of payments from the GB system operator to the transmission owners. Ofgem/DTI reiterated the view expressed in the June 2003 document that they were keen to ensure that the STC

⁴ The SO-TO Code under BETTA:Ofgem/DTI summary of responses and conclusions on the June 2003 document and subsequent mini consultations, and further consultation on the draft legal text; proposals for CUSC changes in relation to limitation of liability; and matters relating to the timescales for processing new connection applications.”, April 2004 90/04.

arrangements would be consistent with the guidelines being produced as a result of the review of credit cover arrangements being produced by the Credit Cover Steering Group. Ofgem/DTI stated that, in the meantime, the issues raised would be considered further and that they expected to consult further.

- 3.8. In the changes to the transmission licences designated by the Secretary of State on 1 September 2004, specific provision⁵ was made, during a transitional period, for the Authority to direct NGC to modify the STC where it considers it necessary or expedient for the implementation of BETTA in a number of circumstances, one of which is arrangements for security. A similar provision⁶ provides for changes to be directed to the CUSC to remove any inconsistency or conflict between the CUSC and a number of other documents, including the STC.

Consultation on credit cover for network operators

- 3.9. In March 2002, Ofgem published a consultation document⁷ that opened a consultation process regarding the appropriate arrangements for covering credit risk and mitigating costs to which parties in the gas and electricity markets are exposed, when a gas or electricity supplier or a gas shipper fails.
- 3.10. In February 2003, Ofgem published its conclusions and proposals⁸ following that consultation. In the document, Ofgem set out its conclusions that:
- existing credit cover arrangements for all Network Operator (NWO) transportation and metering charges (including capacity, commodity, connection and use of system) need to be reformed to bring them into line with best commercial practice in comparable competitive industries

⁵ Transmission Licence Standard Condition B12.

⁶ Transmission Licence Standard Condition C10.

⁷ 'Arrangements for gas and electricity supply and gas shipping credit cover. A consultation document', March 2002, 24/02.

⁸ 'Arrangements for gas and electricity network operator credit cover – conclusions and proposals', February 2003, 06/03.

- these objectives could be progressed by the industry through appropriate governance mechanisms, including modifications to industry codes and agreements, and
- Ofgem should work with the industry to establish mutually agreed best practice guidelines, which should set out the kind of efficient arrangements NWOs would need to demonstrate in order for incurred bad debt losses to be considered for pass-through under network price controls.

3.11. Since then there have been a number of industry workgroups comprising representatives of all segments of the gas and electricity industries, plus external advisors and Ofgem observers, which have developed recommendations for industry best practice.

3.12. In September 2004, Ofgem published views on and, where it disagreed, counter-proposals to, these recommendations for best practice guidelines⁹. In this document, Ofgem suggested guidelines for the unsecured credit that NWOs might afford to counterparties, being 2% of the licensee's Regulatory Asset Value (RAV) for the most credit-worthy users (and commensurately lower limits for less credit-worthy counterparties). NWOs would be expected to require collateral for exposures in excess of these amounts.

3.13. The September 2004 document also suggested that NWOs would be able to recover from other counterparties all or a proportion of charges unpaid by a counterparty at the point that that counterparty became insolvent, depending on how well it had managed the credit risk e.g. in terms of chasing outstanding payments, etc.. In respect of charges arising after insolvency, it was stated that *"NWOs are expected to obtain appropriate protections from the administrator/administrative receiver/liquidator, and would in any event have the protection of paragraph 99 of Schedule B1 of the Insolvency Act (1986)"*¹⁰,

⁹ "Recommendations for best practice guidelines for gas and electricity network operator credit cover. Consultation Document", September 2004, 226/04.

¹⁰ This statement applies in the case that charges are owed by a user that is not a NWO which is in energy

which accords priority in recovery to amounts due in respect of commitments entered into during the period of administration.

administration. Energy administration provides only for the appointment of an energy administrator, not an administrator, administrative receiver or liquidator.

4. Credit risk for transmission owners

- 4.1. Although under BETTA, transmission owners will be reliant for their transmission business almost exclusively on NGC, a number of arrangements already exist or are being introduced by the Energy Act (2004) to safeguard the financial integrity of NGC and to secure the operation of its system in the event of insolvency.
- 4.2. The nature and effectiveness of these arrangements significantly affect the risk for transmission owners of non-payment by NGC, and are described below.

Ring-fencing and statutory obligations

- 4.3. Standard condition B10 of the transmission licence requires that the licence holder maintains an investment grade rating, corresponding to a Standard & Poor's rating of BBB- or Moody's Baa3, or better.
- 4.4. Standard condition B6 requires NGC to be financially ring-fenced. In addition to the condition requiring an investment grade credit rating, the ring-fencing condition requires that, broadly speaking, the licence holder does not undertake any business other than its licensed transmission business that will exceed 2.5% of turnover, or entail investments (which includes the maximum value of any contingent liabilities) of more than 2.5% of share capital, share premium and consolidated reserves of the licensee. There are also restrictions on the uses to which the licensee may put its financial resources, on financial commitments it may incur, and on the transactions it may enter into with affiliates and related undertakings.
- 4.5. In addition, the Secretary of State and the Authority have a statutory obligation under the Electricity Act (1989) to carry out their functions having regard to the need to secure that licence holders are able to finance their licensed activities. Amongst the functions to which this obligation attaches is the setting of revenue restrictions.

Energy administration

- 4.6. If, despite the provisions described above and the statutory obligations of the Secretary of State and the Authority, NGC were to become insolvent, new

provisions in the Energy Act (2004), allow the Secretary of State, or the Authority with the consent of the Secretary of State, to make an application to court for an “energy administration” order to be made.

- 4.7. As with normal administration, during energy administration, the company would be protected from action by creditors to whom debts were owed at the time the company was put into administration. During administration (or energy administration), the administrator (or energy administrator) may continue to incur further debts or “administration expenses”.
- 4.8. Administration expenses rank, in order of preference for payment, above the administrator’s (or energy administrator’s) own remuneration, as well as the pre-administration debts. Thus, in a normal administration, if an administrator cannot meet administration expenses then one option available to the administrator might be to wind up the company. However, in energy administration, the objective of the administration is *“to secure that the company’s system is and continues to be maintained and developed as an efficient and economical system”*, and so winding up of the business is not an option.
- 4.9. During any administration (or energy administration), notwithstanding that the company was unable to pay *all* of its debts, given the temporary relief from the burden of the pre-administration debts, Ofgem considers that it is still possible, and perhaps even likely, that the administrator (or energy administrator) would at least be able to meet the ongoing administration expenses.
- 4.10. Nevertheless, in respect of an energy administration, there are additional powers for the Secretary of State to:
 - (i) make modifications to the licence such that the licensee’s charges can be modified to make good any shortfall in the property available to meet the expenses at the end of energy administration

- (ii) make grants and loans to the licensee¹¹, and to
- (iii) indemnify the energy administrator.

4.11. Furthermore, in accordance with section 3A of the Electricity Act 1989 as amended by Section 190 of the Energy Act 2004, one of the issues which both the Secretary of State and the Authority must have regard to when carrying out their functions in relation to energy administration, is the need to secure that licence holders are able to finance their activities. The reference to licence holders is not restricted to the company in energy administration.

4.12. Thus, for transmission owners not to be paid:

- NGC would have to become insolvent, notwithstanding the requirements for ring-fencing, and the statutory obligation on the Secretary of State and the Authority to act in a manner best calculated to ensure that it can finance its activities
- the CUSC receivables would have to be not only insufficient to fund the licensee's activities, but to be insufficient to do so when relieved of the immediate need to pay pre-administration debts
- the energy administrator would have to exploit the licence obligation on transmission owners to provide transmission services and prioritise payments to them below other administration expenses, and
- the energy administrator would have to have been unsuccessful in finding sources of funding for the energy administration, either from commercial lenders or from the Secretary of State, despite the various provisions under the Energy Act.

4.13. Notwithstanding that this risk is low, recognising the severity of the consequences, Section 5 discusses a number of potential remedies.

¹¹ Although Ofgem understands that an energy administrator would be expected to seek commercial loans before approaching the Secretary of State for a grant or loan.

5. Potential credit cover solutions

- 5.1. A number of solutions can be considered for providing transmission owners with security for payments by NGC, and these are discussed below.

Option 1: Security

- 5.2. A conventional means of providing security is to grant to the creditor a charge over assets of the debtor. The creditor then has first claim over the proceeds of any sale of the assets in order to discharge any debt owed. However, creditors have to apply to a court to enforce the security, and generally security will only protect pre-administration debts and not necessarily expenses during administration.
- 5.3. SPT has stated that the principal risk is not so much in the recovery of bad debt, but in the potential for the severe interruption to its cashflows that non-payment of administration expenses would entail. Debts would be unlikely to run to more than one or two monthly payments before insolvency were declared; indeed a transmission owner itself would be able itself to precipitate administration in the event that it were not paid. As explained earlier, the risk of bad debt can be mitigated by “pass-through”, i.e. allowing recovery through the revenue restrictions in a subsequent period, on condition that the creditor has complied with good credit management practices. These credit management practices might themselves require the creditor to mitigate the risk of bad debt by taking security, but allowing pass-through removes any remaining risk.
- 5.4. In contrast, the period of administration and hence the potential magnitude of the administration expenses owed to it, is beyond the control of the transmission owner and furthermore is not known by it. Consequently non-payment of administration expenses is harder to manage and represents potentially the greater risk.
- 5.5. Thus, security does not address the transmission owners’ concerns both in terms that the enforcement of security will generally not be possible until the end of the (unknown) period of administration and also does not cover the potentially greater risk of non-payment of administration expenses.

Option 2: Cash collateral

- 5.6. Cash collateral or letters of credit can provide security that does not require court action to enforce. However, the unknown period of administration during which time the transmission owner might not be paid means that it could be difficult to determine the appropriate amount of credit cover. Whilst under-provision of collateral would clearly leave the transmission owners exposed, over-provision could involve significant unnecessary cost to NGC and thus ultimately to transmission users.

Option 3: Undertaking to amend the STC and CUSC

- 5.7. Users pay NGC under the terms of the CUSC, and NGC pays transmission owners under the STC. Following insolvency, amendments to these codes could be directed by the Authority such that transmission owners would be paid by Users under the CUSC rather than by NGC under the STC. It would be necessary that there was a consideration in return for payment of the transmission owners by Users. Whilst this is not appropriate in the normal course of events as a principal objective of BETTA is that the contractual counterparty for connection to and use of system should be independent of market affiliations, Ofgem considers that it would not be unacceptable to have a contractual relationship between Users and transmission owners in the event of NGC insolvency given the low probability of such an event.
- 5.8. However, irrespective of the means by which the necessary amendments might be proposed, there is no obvious mechanism whereby the Authority could pre-commit to direct any such an amendment. Accordingly, this approach would seem to offer little additional certainty.

Option 4: Amendment of the STC and CUSC during the transitional period

- 5.9. One way to address the pre-commitment problem above may be to make changes to the STC and CUSC under the transitional arrangements. Amendments would be required such that, whilst prior to any insolvency, transmission owners would be paid by NGC under the normal terms of the STC,

following insolvency, or any other suitably defined trigger, transmission owners would be paid by Users under the CUSC.

- 5.10. However, Ofgem understands that such an arrangement would be unlikely to survive challenge by other creditors of NGC, who would be able to argue that preference was being given to the transmission owners.

Option 5: 'Payment trust proposal'

- 5.11. A further proposal has been considered which has been termed the 'payment trust proposal'.
- 5.12. The payment trust proposal involves CUSC receivables being placed, not in the account of NGC, but in the account of a trustee which holds them on trust for the beneficiaries of the trust.
- 5.13. Under normal circumstances, the distribution of the funds of the trust would be 100% to NGC. NGC would then pay its creditors, including transmission owners, in the normal manner. Upon a trigger event, however, which could be NGC insolvency or non-payment (defined in some appropriate manner) of a transmission owner by NGC, the distribution of funds would change such that transmission owners were paid the amounts owing to them with the remainder of the funds, which it is likely would be the greater part, being distributed to NGC.
- 5.14. Disputes over payments between the trustee and transmission owners could be resolved by NGC and transmission owners using the mechanisms provided in the STC that would resolve such disputes between NGC and transmission owners absent any insolvency.
- 5.15. In order to obviate concerns regarding the financial integrity of the trust, the trustee could be a company set up specifically for the purpose, and would be prohibited from undertaking any other activity. The rules for the distribution of the funds of the trust could be written such that the amounts paid by the trust would be equal to the funds received less the trustee's costs.
- 5.16. The documents setting up the trust, the form of the agreement between the STC Parties and the trustee, and the assignment of CUSC receivables to the trust

would be appended to the STC. The STC would oblige the parties to set up the trust, enter into an agreement with the trustee of a specified form and to meet the expenses of the trustee. An amendment to the CUSC might be required to acknowledge the assignment of funds.

- 5.17. Ofgem understands that such a trust, carefully constructed, may be robust against challenge. As a private agreement, entered into voluntarily by the parties, the arrangement might be vulnerable to challenge by other NGC creditors, but the regulatory obligation to enter into the arrangement would be an important factor in making it robust against challenge. However, Ofgem recognises that it is difficult to be certain *ex ante* that any solution would successfully resist such a challenge. If such a proposal were to be pursued, further work would need to be undertaken (including, for example, seeking Counsel's opinion) to determine the proposal's robustness.
- 5.18. In a variant of the arrangement, transmission owners would receive their revenues directly from the trust at all times, rather than only following insolvency. It is possible that this could further enhance the robustness of the arrangements, although it would represent a greater disruption, under normal circumstances, to the operation of the STC.

Other options

- 5.19. Considerable case law exists as to what may be regarded as an administration expense and what may be classified as a debt pre-existing at the time of insolvency. Ofgem understands that it is extremely unlikely that payments to the transmission owners would not be regarded as administration expenses.
- 5.20. However, to mitigate the risk further that such payments could be considered as falling outside administration expenses, an additional option may be to modify the obligation to provide transmission services such that it is not unconditional.
- 5.21. It should be noted that the obligation on NGC to provide connection to and use of system is not unconditional. NGC's licence obliges it to offer to enter into an agreement, but it is the agreement which places obligations on both parties: on NGC for the provision of services; and on the User for the payment of charges.

- 5.22. A change to the obligation on transmission owner could be achieved quite simply. Condition D2 of the standard conditions applying to transmission owners obliges them to provide transmission services, but to do so in accordance with the STC. A change to the STC could thus make the provision of transmission services conditional upon being paid.
- 5.23. Clearly, though, the benefit in terms of improving the certainty that payments to transmission owners would be classified as administration expenses, would have to be weighed against the fact that the exercise of any right by a transmission owner not to provide transmission services would have severe consequences.
- 5.24. Alternatively, in the event that transmission owners were not paid for the transmission services provided by them during administration, the Authority would need to consider whether such non-payment could constitute a breach of the payment provisions of the STC by NGC and accordingly whether NGC could be considered to be in breach of its licence. If so, the Authority would need to consider whether it would be open to the Authority to take enforcement action for such a breach, where appropriate, by imposing a financial penalty (which may exceed the amounts owed to the transmission owners) or making an enforcement order. It may be that the possibility of such action would be sufficient to further justify an energy administrator treating the payments as expenses of the energy administration.

Summary

- 5.25. Option 1 - conventional security over NGC assets - would provide for the recovery of pre-administration expenses but only after an uncertain period, and would not provide for the timely payment of ongoing administration expenses
- 5.26. Option 2 - cash collateral or letters of credit - would seem to be a solution providing effective security to Transmission Owners both for the recovery of pre-administration debts and the timely payment of ongoing administration expenses. However, given the uncertain duration of an energy administration, an appropriate amount of cover may be difficult to determine, and there is a risk of significant unnecessary costs.

- 5.27. Ofgem understands that Option 4, i.e. changes to the STC and CUSC made prior to any administration, and which result in changes to the cashflows of NGC and transmission owners contingent upon any insolvency, would be vulnerable to legal challenge by other creditors.
- 5.28. Option 3, i.e. changes made to the STC and CUSC during administration might be more robust to challenge, but would rely on future action of the Authority. Given that the need for such action would be precipitated by the energy administrator being unable to obtain funding either from commercial lenders or the Secretary of State, an option relying on the actions of the Authority might be regarded as giving little additional certainty.
- 5.29. Option 5 - a 'payment trust' - has been suggested, which Ofgem understands may be robust against challenge, albeit significant further analysis and legal advice would be required to establish this fact.
- 5.30. Ofgem understands that it is extremely unlikely that payments to transmission owners would not be treated as administration expenses. Nevertheless, changes could be made to the STC which would make the provision of transmission services by transmission owners contingent on being paid for those services, recognising that the exercise of a right to withdraw those services would have major consequences. Alternatively, the possibility of enforcement action by the Authority might be sufficient to ensure that an administrator would regard payments to the transmission owners as being expenses of the energy administration.

6. Assessing the appropriateness of credit cover arrangements

Risk to transmission owners

- 6.1. As discussed earlier, the probability of NGC becoming insolvent is low. Furthermore, even in the event that NGC were to become insolvent, it is still unlikely that the receivables from CUSC Users would be insufficient to meet administration expenses, and it is unlikely that, if not, the Secretary of State would not exercise her powers such that NGC were able to cover its administration expenses, including payments to transmission owners.
- 6.2. Nevertheless, the consequence of non-payment of administration expenses for a protracted period could be serious for transmission owners. Thus it is relevant to weigh the consequences for transmission owners were NGC to become insolvent against the complexity and cost of any solution and the low probability of it being needed. Whilst it is not a specific objective of BETTA that the credit risk for transmission owners should be materially increased, Ofgem notes that there are other unlimited and unmanageable but low probability risks to any business, and thus the existence of any such risk is not unacceptable per se.

Existing risk to transmission licensees

- 6.3. Recognising that current arrangements do not guarantee immunity from any risk whatsoever, it is not necessarily appropriate that the transmission owners should be guaranteed under BETTA total immunity from any risk of default.
- 6.4. The transmission business of SPTL and SHETL currently derive their revenues from a number of sources, including:
 - Infrastructure (Generation) charges paid by generators
 - Infrastructure (Demand) and System Service charges paid by suppliers
 - Entry charges paid by generators
 - Exit charges paid by any directly-connected users, and

- Use of interconnector charges paid by users of the respective shares of the Scotland-England interconnector, and of users of the Moyle interconnector.
- 6.5. In principle, this gives each licensee a diverse portfolio of debtors. Nevertheless, a substantial proportion of the revenues to each transmission owner comes from companies within the same group as the licensee. For instance, in the case of SPTL: exit charges are paid predominately by SP Distribution Limited; ScottishPower-owned generation accounts for over 50% of generation capacity connected to the SPT network, and thereby pays Infrastructure (Generation) charges; ScottishPower's supply business has been successful in retaining a significant share of the supply (particularly domestic) market in SPTL's area, thereby paying Infrastructure (Demand) and System Service; and ScottishPower is understood to be the dominant user of SPTL's share of the Scotland-England interconnector, thereby paying Use of Interconnector charges.
- 6.6. Thus, whilst BETTA will result in almost all of the transmission owners' revenues deriving from NGC, Ofgem estimates from publicly available information that it is the case today that approximately 75% of SPTL's current revenues derive from other companies in the ScottishPower group.
- 6.7. The situation is similar for SHETL, with SSE¹²-owned generation comprising an even greater proportion of the generation connection to SHETL's transmission system than is the case with ScottishPower generation and SPTL's transmission system.

BETTA transitional powers

- 6.8. Finally, the transitional arrangements give the Authority the power to direct changes to the STC and CUSC where it considers them to be appropriate only in certain areas and where such changes are "*necessary or expedient*" for the introduction of BETTA. The powers of the Authority are limited in this way for the protection of the transmission licensees and of other parties, and for the

¹² Scottish and Southern Energy plc ("SSE") is the parent company of SHETL.

Authority to direct an amendment to the STC and/or CUSC under the transitional powers it must be established that this test has been met.

- 6.9. Of course, this does not preclude parties proposing amendments to the STC and to the CUSC, on which the Authority must then determine taking into account wider considerations. It is recognised that the transmission owners are party to the STC, but not to the CUSC. Nevertheless, the provisions for change co-ordination in the STC require the STC Committee to *“establish ... joint working arrangements with each panel or other body responsible for proposing change to the BSC, CUSC or Core Industry Document, to facilitate the identification, co-ordination, making and implementation of change to the BSC, CUSC or Core Industry Document or such other designated documents consequent on an amendment to the Code, in a full and timely manner.”* Thus, consequential proposals to amend the CUSC could follow any proposed amendment to the STC.

7. Views invited and way forward

- 7.1. Views are invited on the issues raised in this consultation paper. In particular, views are sought on whether it would be appropriate for the Authority to direct changes to the STC and the CUSC in order to address the issues identified:
- taking into account the risk profile of transmission owners under BETTA as compared to the risk profile of those licensees currently, and
 - bearing in mind whether any resulting amendment to the STC or CUSC passes the test of being necessary or expedient that limits the Authority's powers to direct change, or whether it would be appropriate that such an amendment be progressed through the enduring amendment process of the STC.
- 7.2. Ofgem will consider responses received and will publish a conclusions paper early in the New Year. Depending on whether or not a specific change is considered necessary or expedient for the implementation of BETTA, the Authority would make the appropriate changes to the STC and CUSC using the transitional powers granted to the Authority by B12 and C10 of the transmission licence standard conditions.
- 7.3. Notwithstanding the above, the STC Parties could propose an amendment to the STC at any time, which the Authority would then consider under the enduring arrangements for amendment of the STC. Any amendment of the CUSC would use the enduring arrangements for cross-code change co-ordination.