ANNEX 1 – LEGAL SUBMISSIONS

In this annex, we set out a number of legal submissions on which we request that the Authority should reflect carefully in considering its decision on the proposed modification.

In section A of this annex, we set out the principal legal duties and standards engaged by a decision of the Authority to approve the proposed modification. We submit that approval of CAP 170 would be contrary to these duties and standards. We also submit that the procedure so far, including National Grid's consultation and the Authority's impact assessment and consultation, have been seriously defective. In sections B to J of this annex we make further submissions on particular points: these are not intended to be exhaustive. These submissions should be read together with the points made in (a) our consultation response letter and (b) the other annexes enclosed with our response, including the expert report from Oxera (the **Oxera Report**).

A. Legal duties and standards engaged by decision to approve the proposed modification

A.1 We set out below the various legal duties and standards which are engaged by a decision of the Authority to approve the proposed modification.

The BETTA market – section 133 Energy Act 2004

A.2 Section 133(1) contains the statutory definition of the 'new trading and transmission arrangements' –

"*(1) References in this Chapter to the new trading and transmission arrangements are to new arrangements relating to the trading and transmission of electricity in Great Britain designed—*

(a) to promote the creation of a single competitive wholesale electricity trading market, and

(b) to introduce a single set of arrangements for access to and use of any transmission system in Great Britain".

A.3 National Grid's licence conditions were determined by the Secretary of State under s. 137(1) of the Energy Act 2004 for the purpose of implementing the new trading and transmission arrangements, as defined in section 133(1) of the 2004 Act.

A.4 The statutory definition in section 133(1) is relevant in construing the Licence conditions, including Condition C10 in National Grid's licence. The statutory definition also defines the statutory object and purpose of the creation of the BETTA market.

Standard Licence Condition C10

A.5 Standard Licence Condition C10 which is in effect in National Grid's licence provides, by paragraph (1) that-

"*The licensee shall establish arrangements for connection and use of system in respect of matters other than those to which standard conditions C14 (Grid Code) and C5 (Use of system charging methodology) to C9 (Functions of the Authority) relate which are calculated to facilitate the achievement of the following objectives:*

(a) the efficient discharge by the licensee of the obligations imposed upon it under the Act and by this licence; and

(b) facilitating effective competition in the generation and supply of electricity, and (so far as consistent therewith) facilitating such competition in the sale, distribution and purchase of electricity".

National Grid's statutory and licence duties

A.6 National Grid is required by section 9(2) of the Electricity Act 1989, "(a) to develop and maintain an efficient, co-ordinated and economical system of electricity transmission; and (b) to facilitate competition in the supply and generation of electricity".

A.7 National Grid also has similar duties in terms of its licence (including those referred to in paragraph A.5 above). In addition, it has a duty of non-discrimination in terms of standard condition C16 which is effect in its transmission licence.

Section 3A(1) Electricity Act 1989 – The Authority's principal objective

A.8 Section 3A(1) of the Electricity Act 1989 provides –

"The principal objective of the Secretary of State and the Gas and Electricity Markets Authority (in this Act referred to as "the Authority") in carrying out their respective functions under this Part is to protect the interests of existing and future consumers in relation to electricity conveyed by distribution systems or transmission systems, wherever appropriate by promoting effective competition between persons engaged in, or in commercial activities connected with, the generation, transmission, distribution or supply of electricity or the provision or use of electricity interconnectors".

A.9 The competition requirement in the Authority's principal objective applies both (a) to the wholesale market and (b) to the ancillary services market. The competition requirement is a strong requirement. If it is possible to protect consumers by competitive measures then these measures should be adopted by the Authority.

A.10 The statutory definition of the BETTA market in section 133(1) of the 2004 Act shows that it is Parliament's intention that the wholesale market in Great Britain should be a single competitive market and should not be segmented.

The Authority's further duties under Section 3A(5) of the Electricity Act 1989

A.11 The Authority's further duties under section 3A(5) of the Electricity Act 1989 include

A.11.1 promoting efficiency and economy on the part of persons authorised by licences or exemptions to distribute, supply or participate in the transmission of electricity or to participate in the operation of electricity interconnectors and the efficient use of electricity conveyed by distribution systems or transmission systems;

A.11.2 protecting the public from dangers arising from the generation, transmission, distribution or supply of electricity; and

A.11.3 securing a diverse and viable long-term energy supply, and (so far as not otherwise required to do so by this subsection) shall , in carrying out those functions, have regard to the effect on the environment of activities connected with the generation, transmission, distribution or supply of electricity.

The Authority's Better Regulation Duties – Section 3A(5A)(a) and (b) of the Electricity Act 1989

A.12 Section 3A(1) of the Electricity Act 1989 provides –

"In carrying out their respective functions under this Part in accordance with the preceding provisions of this section the Secretary of State and the Authority must each have regard to—

(a) the principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed; and

(b) any other principles appearing to him or, as the case may be, it to represent the best regulatory practice".

A.13 The transparency obligation applies in the preparation, publication and consultation on the Impact Assessment on CAP 170, and to any Decision of the Authority to implement CAP 70. This obligation is all the more important since CAP 170 was effectively initiated by the Authority. (See in this connection, decision of the Competition Commission in Appeal CC02/07 (E.ON UK Plc and GEMA), para. 6.196).

Impact Assessment – Section 5A of the Utilities Act 2000

A.14 Section 5A of the Utilities Act 2000 provides (so far as relevant to the Authority's decision to carry out an impact assessment in this case) that-

"*(4) An assessment carried out under this section must–*

(a) include an assessment of the likely effects on the environment of implementing the proposal; and

(b) relate to such other matters as the Authority considers appropriate.

(5) In determining the matters to which an assessment under this section should relate, the Authority must have regard to such general guidance relating to the carrying out of impact assessments as it considers appropriate.

(7) Where the Authority publishes an assessment under this section–

(a) it must provide an opportunity of making representations to the Authority about its proposal to members of the public and other persons who, in the Authority's opinion, are likely to be affected to a significant extent by the proposal's implementation;

(b) the published assessment must be accompanied by a statement setting out how representations may be made; and

(c) the Authority must not implement its proposal unless the period for making representations about the proposal has expired and it has considered all the representations that were made in that period".

A.15 Reference is also made to guidance provided by the OFT and Treasury on the preparation of impact assessments.

The Authority's procedural obligations under public law

A.16 The Authority is also subject to procedural duties in public law, in particular duties relating to the taking of decisions in an fair and open-minded manner.

A.17 In relation to the conduct of consultation exercises, the Authority should observe the following principles, i.e., (a) consultation should take place when the proposals are at a formative stage; (b) the proposer must give sufficient reasons to permit an intelligent response; (c) there must be adequate time for consultation and for consultees to respond and (d) the product of the consultation must be taken into account in the final proposals.

Human Rights Act

A.18 The provision of Article 1 of Protocol 1 of the European Convention on Human Rights provides -

"Every Natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law.

The preceding provisions shall not, however, in any way impair the right of a state to enforce law as it deems necessary to control the use of property in the general interest or to secure the payment of taxes or other contributions or penalties".

EU Law

A.19 There are a number of EU instruments which are of particular relevance to the matter in hand. These include the following:-

A.19.1 Directive 2003/54/EC (the IME Directive), see in particular recitals (2), (4) to (8), (13), (15), (17), (18), (31), (32) and Articles 1, 3(1), 3(2), 9 (a), (c) and (e), 11(2), 11(6), 11(7), 20(1), 20(2), 23(1), 23(2), 23(4), 28(2), 28(3).

A.19.2 Directive 2001/77/EC (the Renewables Directive), see in particular recitals (2) and (22) and Article 7(1), 7(2), 7(6), and Directive 2009/28/EC, see in particular Article 16(2).

A.19.3 Directive 2005/89/EC (the Safeguards Directive), see recitals (10), (12) and (18) and Articles 3(2)(B), 3(4), 5(1)(a) and (b), 6(1)(a).

A.19.4 Regulation (EC) 1228/2003 – Access to the network for cross-border exchanges Recitals (4) and (17) and Article 6, especially 6(1) and 6(2) and Annex, 'General', paragraphs 1, 2, 3.

General Principles of EU Law

A.20 In addition to the specific legislative duties and standards referred to above, the Authority must also comply in this context with its general EU law duties as regards non-discrimination, proportionality, certainty and non-retroactivity.

B. First submission - distortion of competition in the GB wholesale electricity market

B.1 Approval of the proposed modification would result in the distortion of competition in the GB wholesale electricity market contrary to the interests of ScottishPower in a manner inconsistent with the legal duties and standards summarised in section A above.

B.2 The introduction of CAP 170 would fundamentally undermine the level playing field that BETTA was designed to introduce across Scotland, England and Wales. At its simplest level, the effect of the imposition of administered intertrip on Scottish generators would be to restrict their ability to compete in the GB wholesale market. The impact assessment fails to recognise or consider this.

B.3 The regulatory uncertainty that this proposal would introduce for generators is likely to undermine new investment by generators (in relation to existing plant and/or new plant) and in this way, competition in the GB wholesale market will be distorted.

B.4 We would also refer to the Oxera Report which, for instance, cites the OFT's view that the imposition of maximum prices may also lead to some suppliers exiting the market and may distort the choice of products supplied (Oxera Report, paragraph 1.33).

B.5 CAP 170 is contrary to the statutory objective for BETTA as enacted in section 133 of the Energy Act 2003 (see A.2 above). It has the effect of segmenting the GB single competitive wholesale market contrary to Parliament's intention.

B.6 Finally, as noted at in section D below, the discriminatory treatment of particular generators in this way will result in the distortion of competition within the GB wholesale market.

C. Second submission - distortion of competition in the GB balancing services market

C.1 Approval of the proposed modification would result in the distortion of competition in the GB balancing services market contrary to the interests of ScottishPower in a manner inconsistent with the legal duties and standards summarised at section A above.

C.2 Competition in the balancing services market will be distorted in a number of ways: (a) the replacement of a competitive market with an administered regime at least for certain generators (competition will deliver cost related prices, equal prices, however, will not deliver competition); (b) generators subjected to category 5 intertrip will be prevented from participating in the commercial market for the provision of intertrip services and other balancing services (when category 5 applies); and (c) as the level of payment neither reflects the economic value of the service nor is it cost reflective, those generators on whom it is placed will be at a commercial disadvantage in the wider balancing services market as compared to those that are free to agree a commercial price.

C.3 The continued development of the balancing services market has been noted by National Grid as resulting in constraint costs that have been lower than expected/budgeted. To interfere in a commercial market that is delivering such efficient outcomes will only increase the distortion in this market.

C.4 As pointed out in the Oxera Report (paragraph 1.3), the impact assessment fails to (a) establish the relevant market being assessed, (b) demonstrate competition in the market is ineffective, (c) provide evidence that prices for commercial intertrip do not reflect competitive levels, (d) explore the evolution of market dynamics or the experience of innovation, or (e) analyse options (including market-based options) other than administered prices.

C.5 The Authority does recognise (at least in the following specific context) the anti-competitive effect of CAP170 at paragraphs 3.36 and 3.37 of the impact assessment: "*If the payment generators receive for this service is regarded as inadequate and does not always reflect the costs associated with the provision of intertrip we note that an administered pricing arrangement might be regarded as a barrier to entry, or as having an adverse impact on existing generation*. *As discussed earlier in this chapter, the administered payment proposed under CAP170 is the same as that which applies to the other categories of system-to-generator intertripping schemes. It may therefore be argued that, to the extent introducing an administered price is an improvement on the status quo and results in more efficient costs overall, then it is appropriate to remunerate generators in line with the existing administered price, which was determined to be reasonable by the CAP076 working group and should therefore remunerate generators appropriately for this service*".

C.6 The Authority is correct to identify the barriers to entry and potential distortions of competition which would result from the introduction of CAP170. However, it fails to provide a credible justification for such a situation. It offers no explanation as to why the imposition of an administered price should be regarded as 'an improvement on the status quo' or why the imposition of such a price should result in 'more efficient costs overall' (as opposed to amounting to a mechanism by which National Grid is allowed to avoid paying a price which reflects the economic value of the service in question). Nor does it explain why the administered price payable under the CAP076 arrangements should reasonably be applicable in this context.

C.7 At paragraph 3.38 of the impact assessment the Authority notes: "*It might also be argued that CAP170 could create a barrier to entry or adversely impact the competitive position of existing generation, as generators may be concerned that they could be selected to provide administered intertrip when they were previously benefitting from commercial arrangements with NGET. It could be argued that this would introduce a new regulatory risk and have an adverse impact on investment decision in the GB generation market. In this context, we note that any uncertainty about the selection of generators required to provide this service is likely to be mitigated where NGET is required to comply with a clear methodology and where future and existing market participants can understand fully the criteria NGET will apply in identifying who will provide this service, and when that service will be utilised*".

C.8 Again, the Authority is correct to identify the barriers to entry and potential distortions of competition which would result from the introduction of CAP170. However, those barriers and distortions result primarily from the imposition on certain generators (rather than others) of

duties to provide administered – rather than commercial – intertrip in the first place. The barriers or distortions which may arise from uncertainty as to which generators will be selected to provide this service are secondary in nature. The Authority fails to address these primary effects in its discussion of National Grid's procurement methodology.

C.9 Finally, as noted at in section D below, the discriminatory treatment of particular generators in this way will result in the distortion of competition within the GB market for balancing services.

D. Third submission – discrimination against GB generators located in Scotland and against particular GB generators within that class

D.1 Approval of the proposed modification would result in discrimination against ScottishPower contrary to the legal duties and standards summarised at section A above.

D.2 The generators who are the object of CAP170 participate in a GB-wide competitive wholesale and balancing services markets.

D.3 CAP170 treats the class of generators who are to provide the proposed administered intertrip services (the **Relevant Class**) differently (and adversely as regards ability to earn a commercial margin) in comparison to other participants in these markets. Further, in so far as it appears to be targeted specifically at the main providers of commercial ancillary services in Scotland at present, CAP170 treats those providers differently to others in the Relevant Class. This suspicion is confirmed by the statement at paragraph 3.60 of the impact assessment that, "*NGET will not be asking any providers beyond those that currently have intertrip schemes installed to install* [the] *equipment* [needed to provide category 5 intertrip]". No explanation or justification for such an obviously discriminatory approach (which was not canvassed in the relevant National Grid consultation) is offered by the Authority. Lastly, the administered prices proposed to be paid under CAP170 for providing intertrip services treat all providers of those administered services in a similar fashion without regard to the different costs incurred by them in providing the services.

D.4 This differential treatment has not been (and, we consider, cannot be) objectively justified by National Grid or by the Authority as required by law. In particular, there is no logical justification for requiring members of the Relevant Class to shoulder a substantially larger share of the burden of managing constraints arising at derogated non-compliant boundaries than any other users of the GB system. There is also no logical justification for requiring the principal current providers of commercial ancillary services in Scotland to assume this burden to a larger extent than others in the Relevant Class. Finally, there is no logical rationale for failing to recognise, in the administered prices payable by National Grid, the different costs incurred by members of the Relevant Class in providing the proposed intertrip service.

D.5 We note that, at paragraph 3.42 of the impact assessment, the Authority suggests that the discriminatory treatment of generators located behind a non-compliant boundary under CAP170 may be objectively justified in the following manner: "*We consider that benefits enjoyed by such generators being allowed to access the system and the market ahead of transmission reinforcement should be balanced by an appropriate duty to contribute to limit the costs caused by the overselling of access rights. We further note that the arrangement put in place by CAP076 was aimed at striking a similar level of balance for generators under similar circumstances of generating capacity exceeding relevant transmission capacity. Lastly, in respect of the Cheviot boundary, the argument for due discrimination may be given further weight, to the extent that there are issues with market power behind that boundary*".

D.6 These suggested justifications are not credible. First, it is inappropriate to treat generators who were granted rights of access to the transmission system in Scotland prior to the introduction of BETTA and those who may have obtained access subsequently in the same way. The conditions under which the former obtained access (and the expectations legitimately formed by them) cannot reasonably be compared to those applicable to the latter. Second, the circumstances which the CAP076 arrangements were designed to address are not comparable to those addressed by the proposed CAP170 arrangements, in particular:-

D.6.1 applying similar treatment to generators that will be subjected to category 5 intertrip and generators which agree to categories 2 and 4 intertrip as a condition of their connection whilst failing to recognise the material differences that exist between them constitutes undue discrimination; and

D.6.2 applying a single level of payment to all generators that are subjected to category 5 intertrip irrespective of their age, size or technology fails to take account of the differences that exist between those generators (e.g., in terms of greater imbalance exposure that will be faced by larger generators) and also, the different values of the service provided to National Grid by different generators, e.g., depending upon the size of the plants.

D.7 Third, as to the justification relating to so-called 'issues with market power', it is not explained either what such 'issues' may be or why they should give weight to discrimination against relevant generators. Also see, in this respect, the concerns also raised in the Oxera Report, paragraphs 1.8 to 1.12.

D.8 The discriminatory treatment of particular generators in this way will result in the distortion of competition within the GB markets mentioned above.

E. Fourth submission – CUSC objectives not satisfied

E.1 Adoption and approval of the proposed modification is not justified in light of the CUSC objective specified in standard condition C10.1(a). There is no finding by the Authority to the effect that adoption or approval would lead to the "efficient discharge" of National Grid's obligations. In this respect, see paragraph 1.7 of the Oxera Report.

E.2 In addition, adoption and approval of the proposed modification is not justified in light of the CUSC objective specified in standard condition C10.1(b). CAP 170 does not facilitate effective competition in generation and supply of electricity. In fact, it distorts competition in the wholesale market. In this respect, see paragraph 1.35 of the Oxera Report.

F. Fifth submission – unjustified interference with possessions contrary to Human Rights Act 1998

F.1 Approval of the proposed modification would result in the unjustified interference with ScottishPower's possessions (in light of the applicable legal standards summarised in paragraph A.18 above).

F.2 A number of generators including ScottishPower enjoy contractual rights as regards (a) access to the GB transmission system and (b) the provision of commercial intertrip services to National Grid. They also have interests as proprietors of businesses which engage in the provision of such commercial services. These rights and interests constitute possessions for the purposes of Article 1 of Protocol 1.

F.3 The adoption and implementation of the proposed amendment will result in interference with such generators' enjoyment of those possessions within the meaning of A1P1.

F.4 The interference does not meet the test for justification recognised under A1P1. In particular, it does not satisfy the requirements of legal certainty and proportionality imposed by A1P1. Specifically, there is no provision in the proposed amendment under which affected generators would be adequately compensated for the interference with their possessions.

F.5 In its final amendment report, National Grid noted in response to these points that CAP170 does not seek to bring any existing commercial services agreements to a premature end and that any such termination would need to be agreed by the relevant parties.

F.6 We acknowledge that CAP170 does not seek to terminate existing commercial services agreements. However, our point is that CAP170 will (by rendering these agreements

redundant) interfere with the enjoyment of the rights conferred on the relevant commercial service providers. We also note that National Grid did not respond in its final amendment report to the additional points made by us as regards interference by CAP170 with (a) contractual rights of access to the GB transmission system and (b) interests in businesses which engage in the provision of commercial services.

F.7 In its impact assessment the Authority states (at paragraph 3.54) that "*NGET currently has a number of existing commercial contracts in respect of the provision of intertrip for the Cheviot boundary. We note that such commercial arrangements are outside the scope of the CUSC. If CAP170 were to be approved, we would expect NGET to enter into appropriate agreements under the CUSC, with administered prices*". This statement ignores the 'stranding' of the existing commercial intertrip arrangements, which we have emphasised to National Grid.

G. Sixth submission – failure of National Grid to conduct a proper process for adoption of the proposed modification

G.1 In view of the failure by National Grid to conduct a proper process for the adoption of the proposed modification (in light of the applicable legal standards summarised in section A above), the Authority would be acting improperly by approving the modification.

G.2 In responding to National Grid's own consultation on CAP170, we expressed our concern at the failure of National Grid to observe the requirements of due process in developing and purporting to consult on the proposed amendment. We also note that the CUSC Panel, in voting against adoption of the proposed amendment, expressed concern against the use of the urgency procedure and the majority of the Panel were of the view that had they been aware of the breadth of the impact of CAP 170 they would not have voted for the urgency procedure.

G.3 In its final amendment report National Grid noted in response to the concerns raised by ScottishPower that it was following the urgent CUSC process set out in the CUSC and as prescribed by the Authority in its decision on urgency.

G.4 Resort to the urgent CUSC process does not, in our submission, excuse or explain the failures (highlighted by us and other respondents) to observe the requirements of due process in developing and consulting on the current proposal.

G.5 In terms of the original CAP 170 proposal, industry was afforded only 10 days to respond on the basis that the proposal was urgent. The effect of this was that there was no scope for ScottishPower or others to put forward alternative proposals or carry out a working group assessment. National Grid considered the responses and issued its recommendation to Ofgem on the 25 March 2009. Until Ofgem issued its impact assessment (on 21 May 2009) some two months later no further action (in relation to the main proposal) was taken. It is clear from this delay that a more conventional modification process could have been followed.

G.6 The failure by National Grid to issue the consultations on the procurement guidelines and the balancing principles statement with the main CAP 170 consultation rendered it impossible for ScottishPower and others to fully consider and respond to the main proposal as it was (and indeed remains) unclear as to how the selection process will operate in relation to category 5 intertrip.

H. Seventh submission – failure of the Authority to conduct a proper impact assessment on the proposed modification

H.1 The impact assessment prepared by the Authority in relation to the proposed modification is defective in light of the applicable legal duties and standards (as discussed at paragraphs A.14 and A.15 above).

H.2 The Authority states in the 'Overview' section of its impact assessment as follows: "This document does not express a view on the merits of CAP170 or a decision on the proposal.

The Authority will make its decision following consideration of, amongst other things, responses to this impact assessment".

H.3 This approach is inconsistent with s.5A of the Utilities Act, which requires the Authority to conduct an impact assessment on its proposed decision in relation to CAP170. Given that the Authority has not expressed a view on the merits of CAP170 nor, consequently, as to what it proposes to decide, the impact assessment it has published does not comply with the requirements of s.5A.

H.4 There is a consistent lack of analysis throughout the impact assessment. In this regard, we would refer to paragraph 1.41 of the Oxera Report headed 'Limitations to the appraisal of Ofgem's analysis' which contains a lengthy list of areas on which further analysis should have been provided.

H.5 In addition, we would refer to the following failures to provide adequate analysis and assessment in the impact assessment.

Undue exploitation of market power

H.5.1 In considering the potential impact of CAP170 on the market for ancillary services, the Authority notes (at paragraphs 3.30 – 31 of the impact assessment) that this market is, "*vulnerable to the undue exploitation of market power*", and that, "*there may be increased scope for undue market exploitation*". The Authority does not explain what it means by the expressions 'market power' and 'undue exploitation', nor why any weight should legitimately be placed upon them in reaching any decision in this case. Nor does the Authority assert that (or provide any evidence to show why) a situation described by such expressions does in fact exist.

H.5.2 In addition, the Authority notes, at paragraph 3.33 of the impact assessment, that concentration in the generation market in Scotland, taken together with other factors, "*may potentially influence*" the price paid by National Grid for intertrip and other ancillary services. It does not assert (or provide any evidence to show why) such influence actually exists or that what impact it produces, e.g., in terms of higher prices.

H.5.3 Also see, in this respect, the concerns also raised in the Oxera Report, paragraphs 1.8 to 1.11.

Level of administered price

H.5.4 The impact assessment fails to provide any analysis on the extent to which the proposed administered price adequately reflects the costs incurred by those upon whom the category 5 scheme would be imposed. Evidence of the sort supplied by us (along with our consultation response) in our confidential annex on costs ought to have been taken into account by the Authority.

H.5.5 In addition, the impact assessment fails to analyse the key differences that exist between the proposed category 5 intertrip and the other categories of operational intertrip. In this respect, we would refer to paragraph 3.21 of the impact assessment, which notes that the Authority has not yet identified a material difference between new category 5 intertrip scheme and existing operational intertrips that receive the administered payment under the CAP076 arrangements and that, to that extent, it considers it appropriate to apply the same price to the new category of intertrip as that which applies to existing operational intertrip categories.

H.5.6 As explained at paragraph D.6 above, category 5 intertrip differs materially from other categories in terms of (a) the class or classes of generators who may be required to provide the service in question, (b) the alternatives to category 5 intertrip available to National Grid, including commercial intertrip services and other forms of ancillary service, (c) the fact that category 5 intertrip will be imposed retrospectively whilst the other categories will be agreed as a condition of

connection and (d) the effect of category 5 will be to restrict competition whilst the effect of other categories of intertrip are to increase competition as they enable generators to connect to the system earlier than would otherwise have been the case.

H.5.7 Later, at paragraph 3.37 of the impact assessment, it is stated that the existing administered price, "*was determined to be reasonable by the CAP076 working group*". This is not true. In fact, the CAP076 working group recommended that CAP076 (as originally proposed) and four working group alternative amendments should proceed to wider consultation. These alternatives involved supplementing the original proposal with (a) a bilaterally agreed arming fee based on the cost of insurance, (b) an administered arming fee specified in the CUSC, (c) a post event claims process for any resultant physical plant damage and (d) an administered arming fee specified in the CUSC plus a post event claims process for any resultant physical plant damage (i.e. (b) plus (c)). It was the Authority - and not the working group - which determined that the administered price under CAP076 in its originally proposed form was reasonable.

Extent of market for provision of balancing services

H.5.8 The Authority has failed to assess the extent of the market that exists for the provision of balancing services and indeed, how this has developed over time. It is clear from National Grid's recent constraint figures (referred to in our consultation response letter) that costs have been lower than expected which demonstrates that the market is working. The Authority should also have taken into account the readily available evidence of market activity of the sort contained in the market development annex supplied with our consultation response.

See also in this respect the analysis contained in the Oxera Report on the substitution possibilities available to National Grid in relation to commercial intertrip (at paragraphs 1.15 to 1.19).

H.6 The impact assessment also makes no attempt to quantify the cost of increased regulatory risk perceived by the electricity generation market in terms of (a) the replacement of a competitive market for the provision of balancing services with an administered pricing scheme and (b) the urgent process used to force the change upon that market.

H.7 The purported quantitative analysis is not a proper analysis. It departs from the guidance given in the Treasury and OFT Guidelines. It excludes costs to the generators. Consequently it does not provide an assessment of the efficiency of CAP 170.

H.8 Finally, we note that the Authority states that it expects to receive reports from National Grid on its proposed changes to its procurement guidelines and balancing principles statement by July 2009 (see paragraphs 2.26 and 2.30 of the impact assessment) and that it proposes to reach its decision on these changes in consistent timescales with CAP170. This means that the impact assessment fails to consider and assess one of the central aspects of CAP 170, i.e., the selection methodology that will be adopted by National Grid.

I. Eighth submission – failure of the Authority to conduct a proper consultation exercise in relation to its impact assessment

I.1 The consultation being conducted by the Authority in relation to its impact assessment falls short of the requirements of the legal duties and standards which are engaged in this instance (as discussed at paragraphs A.14 and A.15 above).

I.2 As a result of the Authority's failure to adequately assess the impacts of the proposal (as outlined above) this has made it impossible for ScottishPower and others fully to consider and respond to the issues canvassed in the impact assessment consultation.

I.3 The urgent timetable adopted for CAP 170 has exacerbated the difficulty for industry to respond to the various consultations. In this context, it should be noted that there has been

no opportunity for a robust, independent working group assessment to be undertaken of the adequacy or appropriateness of the administered price payable to affected generators. We note that, at paragraph 3.53 of the impact assessment, the Authority suggests that a post-modification working group review would provide an opportunity for the issues CAP170 seeks to address to be further considered, and further proposals raised if appropriate. In view of the speed with which category 5 intertrip schemes are intended to be imposed following approval of CAP170 (and the serious consequences for affected generators of operating under such schemes), such ex-post review is no substitute for a thorough ex-ante assessment.

I.4 It is clear from the impact assessment that the severely truncated "urgent" process adopted has not allowed Ofgem fully to assess – and to consult on – the impact of CAP170. At paragraph 3.2 of the impact assessment (referring to the procurement guidelines and balancing principles statement consultations) it states, "*we have taken account of the consequential changes* […] *(where these have been available in advance of publication of this impact assessment)*". In addition, as noted at paragraph G.6 above, the Authority states that it expects to receive reports from National Grid on its proposed changes to its procurement guidelines and balancing principles statement by July 2009 and that it proposes to reach its decision on these changes in consistent timescales with CAP170.

I.5 Considering the fundamental importance of the changes to the balancing principles statement and procurement guidelines to the implementation of CAP170, this is a significant defect in the process and it has denied to ScottishPower and others the possibility of taking these changes into account in responding to the Authority's impact assessment. Given that the proposed changes to those documents were drafted at a high level and provide no clear methodology as to how generators would be selected to provide category 5 intertrip, the failure by the Authority to address these matters as part of its consultation further undermines its fairness.

I.6 We are also concerned that central issues may have been prejudged. The process was initiated by Ofgem in a letter to National Grid dated 16 February 2009, in which Ofgem instructed National Grid to conduct an urgent review of, "*what actions and/or changes to the existing commercial and charging arrangements could be made to more effectively manage the costs of constraints*" and that its review should address "*the options for reducing the level of constraint costs*". The impact assessment, in analysing the implementation costs of CAP 170, records that "*in respect of the Cheviot boundary costs are also expected to be minimal as NGET will not be asking any providers beyond those that currently have intertrip schemes installed to install* [the relevant] *equipment*".

I.7 This also suggests that the Authority is privy to information concerning National Grid's intended approach in this respect which has not been properly shared with consultees.

J. Ninth submission – failure of the Authority to comply specific provisions of EU law and also general principles of EU law

J.1 The provisions of the EU Directives and Regulation to which we have referred are material to the Authority's decision because (a) they establish standards binding on the Authority and/or (b) they define the policy of EU law in the context of the Internal Market in Electricity and/or (c) they illustrate the approach taken by the European legislative institutions in analogous cases, and this should be take into account by the Authority in considering its decision on CAP 170.

J.2 The provisions of the Renewables Directives (2001 and 2009) are directly in point, since many of the planned renewable generators will be seeking to locate in Scotland, and will be disadvantaged by potential vulnerability to the CAP 170 compulsory tripping scheme.

J.3 The IME Directive stresses that a 'level playing field in generation' is one of the most fundamental aspects of the Internal Market in Electricity, and that for competition to function, network access must be non-discriminatory, transparent and fairly priced. Imposing the compulsory requirements of CAP 170 onto certain Scottish generators is inconsistent with these basic principles. It also stresses the importance of non-discriminatory, market-based

balancing mechanisms. CAP 170 is discriminatory, is not market-based and undermines the efficiency of other market based mechanisms.

J.4 The Safeguards Directive is directly in point in this case. The Directive addresses security of electricity supply, which includes operational network security. The relevant points include (but are not limited to) –

J.4.1 Article 3(2)(b) which requires Members States to take account of the importance of a transparent and stable regulatory framework. CAP 170 breaches this duty;

J.4.2 Article 3(4) which imposes a duty to ensure that any measures are non-discriminatory and do not place an unreasonable burden on the market actors. CAP 170 breaches this duty;

J.4.3 Article 5(1)(a) which requires Member States to encourage the establishment of a wholesale market framework that provides suitable price signals for generation and consumption (this was also the object of Parliament in legislating for BETTA. CAP 170 is inconsistent with this duty);

J.4.4 Article 5(1)(b) which indicates the importance of market-based measures in balancing the system. CAP 170 is contrary to that policy; and

J.4.5 Article 6 requires Member States to establish a regulatory framework that provides investment signals for the transmission network operators to develop their networks in order to meet foreseeable demand from the market. CAP 170 is contrary to this duty. It introduces into the market for ancillary services a compulsory obligation to make generating plant available for tripping, at an administered price. This not only distorts the market for ancillary services, it also distorts the fundamental investment signals for National Grid as transmission system operator, because the trade-off between balancing services and investment in infrastructure is a standard feature of investment analysis.

J.5 The Access Regulation provides for non-discriminatory market-based solutions and measures for constraint management. Article 6(1), by referring to the network, is on its face directly in point in the present case. Additionally, all these provisions indicate a EU policy endorsement of non-discriminatory market measures. The Authority should take this into account in considering CAP 170.

J.6 A decision to approve CAP 170 would also be contrary to the general principles of EU law on non-discrimination, proportionality and certainty.