

Siobhán Carty
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Ofgem
9 Millbank
London SW1P 3GE

28th September 2010

Dear Siobhán,

Re: Certification of transmission system operators under the Third Package, Consultation

Thank you for your letter of 9th September. This non confidential response is on behalf of the Centrica group of companies excluding Centrica Storage Ltd.

We will be providing detailed commentary on the implementation of the third package in response to the DECC consultation which is running in parallel to this consultation process. Hence in this response we have confined ourselves to brief answers to the questions posed in Appendix 1.

Question 1: Have we correctly identified the GB TSOs that require certification? Are there other TSOs that would require certification?

We agree that Ofgem has correctly identified the TSOs requiring certification. We note and support that the law also requires notification of change of ownership, in our view this should place a clear obligation on certified parties to not just notify changes of ownership, but also to actively seek recertification.

Question 2: Are there reasons why the subsidiaries of National Grid plc that act as TSOs should not be certified according to the OU model? What are these?

There are (two) activities carried out by NG which give rise to some concern over the separation of their duties as TSO and purely commercial operation. These are:

- A. Generation of electricity by a form of turbine driven by gas flows on the National Transmission System (NTS). This project is otherwise known as “BlueNG”. Our concerns are related to the fact that this is a utilisation of part of the Regulated Asset base of National Grid in addition to the potential extraction of energy otherwise used for transportation of gas. Therefore it is

possible that this commercial operation would be reliant upon National Grid's regulated activity as Transmission Owner (TO) and System Operator (SO). We entirely agree with the assertion that NG would be required to divest from this activity in order to comply with the OU model (para 2.13)

- B. Carbon Capture and Storage. This project seeks to make use of a section of the NTS for the capture of CO₂ from generation in the industrial areas around Glasgow and Edinburgh and transportation to St Fergus gas terminal for injection into a disused gas field offshore. This section of the existing NTS has been shown to be redundant and it has been shown that there would be little impact upon existing or projected gas flows. Our concerns are not only related to the separation of the businesses, which is relatively simple to demonstrate, but also to ensuring that the regulated asset is treated in the correct manner. This pipeline is currently part of the Regulated Asset Base (RAB) and its transfer to a commercial area of NG activity must reflect the true current value as well as leading to a corresponding reduction in the remaining RAB. This is required to ensure that there is complete separation and no cross subsidy between the regulated and the commercial activities of NG.

Question 3: What do you think of our proposed approach to certifying the various interconnectors?

While it is clear that new interconnectors will fall within the transmission unbundling provisions, we agree that the existing interconnectors clearly fall within the definition of a TSO under the Third Package.

For interconnectors, we would urge that the future certification be undertaken jointly by both Ofgem and the relevant national regulatory authority of the other EU member state.

We do not consider that there are any concerns with current electricity interconnectors which are stand-alone Joint Ventures and operate as discrete businesses.

As the Irish Gas Interconnector is wholly owned by BGE it follows that certification will be required. Naturally, this should be consistent in its application across the Eire, (Northern) Irish and UK Regulators. We welcome this co-operation.

Both IUK and BBL are owned by multiple parties that also have other related interests within the gas supply, shipping and transportation activity. However, both are operated as discrete businesses. In the case of IUK no single party holds a controlling interest of the company and this does serve to demonstrate that there is effective de-coupling from other activities of the owners. This is not the case with BBL where a single party does hold a controlling interest of 60%. In this case there is an argument for more stringent scrutiny.

The criteria of its exemption under Art 22 of the Second Directive should be re-examined to ensure that these are still "fit for purpose" and provide sufficient comfort that there is no undue influence upon its operation and any exemption granted is in line with the Third Package. When the Article 22 Exemption was granted, , there were no applicable transmission unbundling rules from which exemption would have been requested. While we appreciate that exemptions will remain valid from the second to the third legislative packages, the issues around unbundling are specific and we believe do merit special consideration. In particular, this will be essential post expiry of the relevant

exemption, Ofgem will need to work with the Dutch regulator to ensure an appropriate solution. The Irish line provides a best practice example of a way forward.

As noted above, where ownership changes (or indeed where the interconnectors are owned by JV companies), it will be important to review certification on any change of ownership to ensure the certification remains appropriate.

Question 4: Do you agree that OFTOs should require certification with respect to the unbundling provisions and be obliged to comply with the ownership unbundling model (with possible exceptions noted below)?

We agree that offshore transmission assets should comply with unbundling provisions. Indeed, the OFTO regime currently caters for this and indeed the forthcoming need to adhere to the provisions of the 3rd package was taken into consideration in its design.

Question 5: Do you consider that the arrangements relating to the Scottish electricity transmission companies guarantee more effective independence of such licensees from the vertically integrated undertakings of which they are part of than the provisions of the ITO model? Why?

In some areas, we agree that the present GB arrangements do indeed “go further” than the requirements of the ITO model, for example, as a result of the existence of an independent GBSO. However, the autonomous nature of the ITO in the Third Package (and the requirement that any other separation model be equally as robust as the ITO model) does not sit entirely comfortably with the division of the TO and SO roles in GB, incorporating as it does the SO role and some, but not all aspects of those duties carried out by the TO licensees in GB.

Secondly, the Ofgem consultation states that “under the ITO model, the TSO is required to carry out all of the activities relating to the operation and investment in the network”. We are not sure that currently this is the case. For example, Scottish TOs (rather than GBSO) lead in the planning of their own network outages. While there is a facility for the co-ordination of outages between the Scottish TOs and National Grid as GBSO this is thought to be suboptimal as outlined in National Grid’s consultation on Potential Enhanced Electricity Transmission Owner (TO) Incentives in October 2009, this appears to remain the case based on the further document issued by National Grid in May 2010. One of the key consequences of suboptimal outage planning is the potential for high constraint costs which will ultimately impact end consumer prices.

It is essential that Ofgem scrutinises the arrangements for the separation of SHETL and SPTL from their respective corporate owners to ensure that they are at least as independent as the ITO requirements dictate. Organisational structures are key in delivering individual and corporate behavioural decisions. Thus, foremost in Ofgem’s investigation is the satisfaction of the arrangements governing ‘independence of the staff and the managements of the transmission system operator (article 19 of the third Electricity Directive), ‘supervisory body’ (article 20), and ‘compliance programme and compliance officer (article 21).

Question 6: Are there further areas of investigation or clarification we could consider?

We believe that the key elements of this aspect of the Third Package requirements have been adequately identified.

Question 7: Do you consider our overall approach to the assessment of the Scottish electricity transmission companies against the Article 9(9) derogation appropriate?

While we do not oppose the option of making an Article 9(9) derogation available, based on our comments above we are not certain that the current GB arrangements would qualify on the basis of guaranteeing more effective independence of the TSO than the ITO model without strengthening of the current arrangements. In particular, as noted under question 5 above, greater transparency around operation of and compliance with the current arrangements would be helpful.

If you would like to discuss any points in more detail, I would be happy to help and can be contacted on 07789 570046 or Alison.russell@centrica.com.

Yours sincerely,

Alison Russell
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