

Siobhán Carty
Manager
European Strategy Team
9 Millbank
London
SW1P 3GE

Your ref

Our Ref

Date

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Contact / Extension

Scott Mathieson
01698 413466

Dear Siobhán,

**Certification of transmission system operators under the Third Package –
Consultation July 2010 (Ref: 97/10)**

This response is on behalf of SP Transmission Limited (SPT), which owns and maintains the electricity transmission network in south and central Scotland. We have focused our comments on the questions raised within Chapter 3 relating to Scottish Transmission Arrangements.

In assessing whether the Scottish transmission arrangements meet the test of guaranteeing more effective independence of the TSO than the provisions of the Independent Transmission Operator (ITO) model, we note that Ofgem will consider both the separation of functions between the Scottish Transmission Owners (TOs) and the System Operator, and the ring-fencing and business separation provisions applicable to the TOs, so that the effect of the combination of these can be compared with the ITO requirements. We believe that SPT's case for certification under the Directive through the Article 9(9) derogation is very strong when assessed on this holistic basis.

Following on from our previous submissions on this matter, we strongly believe that the existing GB transmission arrangements have proven to be very effective over the past five years following the implementation of BETTA. We operate under strict licence and industry code obligations, which ensure that all grid users benefit from an economic, efficient and coordinated transmission system. These obligations include comprehensive compliance arrangements designed to ensure that SPT is managerially and operationally independent.

Under the GB transmission arrangements, the market function is managed solely by National Grid as the National Electricity Transmission System Operator (NETSO) thus ensuring that the GB transmission system operates on a level playing field, with non-discriminatory and transparent access to the system, and balanced investment in maintaining and upgrading the system. Indeed, we regard these arrangements as being clearly superior to the Independent Transmission Operator (ITO) model.

New Alderston House, Dove Wynd, Strathclyde Business Park, Bellshill, ML4 3FF

Telephone: 01698 413000, Fax: 01698 413053

www.scottishpower.com

SP Transmission Ltd, Registered Office: 1 Atlantic Quay, Glasgow, G2 8SP Registered in Scotland No. 189126 Vat No. GB 659 3720 08
SP Manweb plc, Registered Office: 3 Prenton Way, Prenton, CH43 3ET Registered in England and Wales No. 2366937 Vat No. GB659 3720 08
SP Distribution Ltd, Registered Office: 1 Atlantic Quay, Glasgow, G2 8SP Registered in Scotland No. 189125 Vat No. GB 659 3720 08

These arrangements are ultimately overseen by a strong and experienced regulator with the power to amend and impose licence conditions on the three GB Transmission Owners (TOs) either on 28 days' notice with licensees' consent or following review by the Competition Commission, without such consent. This ensures that the TOs and the NETSO must operate with transparency and fairness at all times.

Finally, we would add that with the exceptional level of grid investment required to facilitate climate change targets, there is considerable benefit in maintaining the current arrangements, which are based on three financially strong transmission companies with the capability to invest in, and develop, their respective grid networks. The presence of three experienced operators in the transmission market is also beneficial to consumers because of the additional information this gives Ofgem in setting price controls. Any significant change would introduce risk and uncertainty into a model that works perfectly well at present.

I have addressed relevant questions in Appendix 1 that accompanies this letter. In addition, in Appendix 2 I have included a note summarising further justification for why "the Scottish Model" more than adequately meets the test for Article 9(9) derogation.

Should you have any questions or require any further information about any of the points raised, please do not hesitate to contact me using the details above or Rupert Steele on 020 7651 2012.

Yours sincerely



Scott Mathieson
Regulation and Commercial Director

Certification of transmission system operators under the Third Package – Consultation (Ref: 97/10)

Chapter 2 – Unbundling Models for GB TSOs

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?

It will be important that Ofgem takes account of the needs of Renewables Generators in finalising the rules on OFTOs, including with respect to any requirement the generator has to build its own connection. It will be for Renewables businesses, however, to advise Ofgem of their requirements and how best to meet them within the framework of the Directive.

We think that it would be beneficial in terms of maximising competition for OFTO licences if all certified transmission companies were able to bid for these extensions regardless of whether they connect to their existing network, provided that they are to be operated in accordance with the framework that justified the original certification. Although Ofgem have suggested that this option may only be available for OFTOs that are contiguous with their existing network, there seems to be no reason why such a restriction would advance liberalisation and accordingly we think that it may not need to be imposed.

Chapter 3 – Scottish Transmission Arrangements

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?

Yes.

- A strong and experienced national regulator regulates the Scottish Model. Ofgem is considered by the European Commission to be a strong regulator with many years experience in managing GB arrangements. This includes having the power to amend licence conditions either on 28 days' notice with licensees' consent or following review by the Competition Commission, without such consent and to initiate enforcement action where necessary.
- The Scottish Model is more unbundled than the ITO model. Critical market functions are kept entirely separate from any vertically integrated undertaking and provide a greater degree of separation than the ITO model. There is no interface between the Scottish Transmission owners and network users; and
- The Scottish Model is governed by proven and effective licences, codes and procedures which ensure that, above all, independence is guaranteed and all users operate on a level-playing field.

A key element of the British Electricity Transmission and Trading Arrangements (BETTA) that came into effect in April 2005 was the introduction of a single set of arrangements for access to and use of the transmission system in GB. National Grid Electricity Transmission is the NETSO for GB and is independent of generation and supply interests. NGET is responsible for contractual arrangements with system users, for settling and applying use of system charges, for operating the GB transmission system to maintain frequency and voltage, and for managing the balancing mechanism. It is also responsible for coordination of the GB Seven Year Statement that sets out projections for GB network flows and investment.

Both the Scottish TOs are required to make their network available to the NETSO and to plan and develop its network in accordance with the established planning and security standard (GB SQSS). They must coordinate their activities with the NETSO, as well as each other, and they are not permitted to carry out any of the contractual, charging or system operator functions reserved to the NETSO.

The TOs' electricity licence incorporates detailed requirements surrounding the financial and operational independence of the TO e.g. Condition D2 – Obligation to provide transmission services, Condition D4A – Obligations in relation to offers for connection, Special Condition E – Appointment of a Compliance Officer.

Following on from the points above:

The existing arrangements in Scotland reduce the scope for conflict of interest. Because the ITO carries out all system operator functions as defined in Article 12 of the new Directive, there is an inbuilt conflict of interest, at least theoretically, across a wide range of activities. In the case of the Scottish TOs, not only is there no comparable scope for any conflict of interest, but we can also cite the effective working in practice of the Scottish model.

A consequence of the existing arrangements is that the three transmission licensees work together, using coordinated planning assumptions, in producing a GB investment programme. Each licensee is required to provide assessments of constraint costs and other relevant parameters and these are subject to review by the NETSO. The NETSO is the primary source of information on constraints and generation unit data and is in a better position to challenge plans that may distort investment patterns than would be the case under the ITO arrangements. Ofgem closely monitors investment plans and their implementation.

The Scottish model operates within a GB-wide framework for transmission access and wholesale energy trading, and because of this it is more favourable to diversity of players than where an ITO's affiliated generated/retail business is the dominant player in the competitive market. The Scottish model represents greater independence from the affiliated generation business due to the greater diversity of the market in which the Scottish TOs operate.

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

No. We consider that we have been able to clarify and respond positively to the various questions on unbundling raised previously by Ofgem.

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

Article 9(9) of the Directive states that certification may be granted where the national regulator is satisfied that arrangements in place for the transmission operator guarantee more effective independence than the provisions set out in Chapter 5 of the Directive.

In considering whether the Scottish transmission arrangements meet the test of guaranteeing more effective independence of the TSO than the provisions of the Independent Transmission Operator (ITO) model, we note that Ofgem will not set out a line by line analysis of the Scottish electricity transmission companies' compliance against these ITO provisions as Ofgem is not assessing the compliance of the Scottish electricity transmission companies with the ITO model itself.

Instead, Ofgem has summarised the main provisions of the ITO model and then set out in summary the arrangements with respect to the separation of tasks between SHETL and SPTL and the independent SO, NGET, and the licence requirements on SHETL and SPTL to have certain ring-fencing and business separation arrangements in place. This enables the overall level of separation of the two approaches to be compared.

We believe that this approach is correct and clearly demonstrates that the combination of the separation of tasks and the ring-fencing and business separation obligations guarantees a greater level of independence than the ITO requirements. Our case for certification under the Article 9(9) derogation of the Directive is very strong when assessed on this holistic basis.

Appendix 2

The Scottish Model – Further justification for application of Article 9(9)

We have summarized the Scottish Model below. We believe that this Model is more unbundled than the ITO model. Critical market functions are kept entirely separate from any vertically integrated undertaking and provide a greater degree of separation than the ITO model. There is no interface between the Scottish Transmission owners and network users.

- Separation of Transmission, Distribution, Generation and Supply has been in place in Great Britain since 1990 and has been reinforced by the implementation of the Utilities Act 2000 and BETTA in 2005
- Legislation set out in the 1989 Electricity Act underpins the overall operation of the electricity supply industry in Great Britain, ensuring a level-playing field for all parties
- Each business within the industry has a specific licence to which they must adhere – whether Transmission, Distribution, Generation or Supply. These licences set out specific conditions under which they must operate and any breach of these licence conditions may ultimately result in revocation of the licence
- Ofgem has the power to alter licence conditions either on 28 days' notice with licensees' consent or following review by the Competition Commission, without such consent, thereby ensuring that any deficiencies identified can be effectively dealt with through the licence structure
- Ownership unbundling, as provided for by the Electricity Directive, affects the three GB transmission companies covering SP Transmission (SPT) as Transmission Owner, Scottish Hydro Electric Transmission (SHETL) as Transmission Owner and National Grid (NG) as Transmission Owner and Independent System Operator
- Under the transmission licences, the transmission owners are obliged to provide transmission services to the system operator. This means that National Grid as the system operator is the only "customer" and, as a consequence, the TO does not interact directly with network users
- These licences have extensive conditions for each company including to prohibit undue discrimination to facilitate competition in the market and to direct the company to accede and adhere to the relevant industry codes
- SPT has produced a Statement of Compliance as required by its licence, to confirm that they comply with the conditions on independence. They have also an appointed Compliance Officer who completes an annual Compliance Report
- The industry code, which governs the interface between the transmission owner and the system operator, is the System Operator – Transmission Owner Code (STC). In addition to the code itself, there are a number of procedures, which set out, in more detail, how the requirements of the code are to be met.
- Through adherence to the licence conditions and accession to the STC, SPT can be guaranteed to be an effective and independent transmission owner

Based upon the information presented above, and as in our responses to previous consultations and questions raised by Ofgem, we consider that the existing transmission arrangements in Scotland more than adequately meet the test for Article 9(9) derogation.