

Stathis Mokkas
Electricity System Frameworks
Ofgem
9 Millbank
London
SW1P 3GE

Date
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Contact / Extension
Alan Kelly
0141 614 1736

Dear Stathis

Future arrangements for the electricity system operator: its role and structure

We welcome the opportunity to comment on Ofgem's proposals to introduce further separation between National Grid's SO and TO functions as the proposals will have a direct impact for future onshore transmission arrangements and policy. Please read this response in conjunction with our parallel response to the consultation on the Future arrangements for the electricity system operator: the Regulatory Incentives Framework.

SP Distribution plc, SP Manweb plc, and SP Transmission plc. ("the network companies") are the "asset-owner companies" holding Scottish Power's regulated assets and distribution and transmission licences. Scottish Power operates along divisional lines, and together, the activities of these companies fall within the Energy Networks division "SP Energy Networks" (SPEN). This response is from SP Transmission plc (SPT) the onshore Transmission Owner (TO) for the South of Scotland. As a TO we have a statutory duty to ensure that we develop an economic, efficient and coordinated onshore transmission system.

Overall, we agree National Grid Electricity Transmission plc's (NGET's) role as System Operator (SO) needs to evolve to meet the needs of the future electricity system. It is our view that further separation between National Grid's SO and TO functions may be in the interest of consumers and other GB TOs in the future. However, we do not believe it has been demonstrated that the SO needs to become a fully Independent SO at this time. We believe a strong focus needs to be kept on fundamental principles that have underpinned the effective operation of the transmission network historically, and build on these to accommodate the changing nature of the transmission system as described below.

Ensuring partnership and close working relationships

The SO-TO arrangements established through the BETTA regime in 2005 have worked well for GB consumers and it will be important not to undermine these arrangements in the course of separating the SO and TO in England and Wales. At the time of developing the BETTA arrangements, debate focused on the extent of the SO role and the concept of a "shallow" or "deep" SO. In summary this relates to where the following roles and responsibilities are held:

1. Purchase and call-off of balancing services
2. Determining the real-time configuration of the transmission system
3. Switching the transmission system
4. Transmission system investment planning

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5. Construction of new transmission system assets; and
6. Transmission system maintenance

Ultimately, a “shallow” SO was established taking responsibility for the first two activities with the remaining functions falling to the TOs. These BETTA roles are predicated on partnership and close working relationships between the SO and the TOs. This has worked well for GB consumers, for example, we have effectively delivered the following projects jointly with other TOs and supported by the SO:

- SHET-SPT: Approximately doubling the power transfer capacity out of the north of Scotland from that at BETTA go-live via the joint SHE Transmission – SP Transmission Inverarnan, Beaulieu – Denny and Kintyre-Hunterston projects.
- SPT-NGET: An approximate three-fold increase in power transfer capacity from Scotland to England by the end of 2017 from the 2200MW north to south capability existing at BETTA go-live. This includes the TIRG upgrade as well as the installation of series compensation, the first such application of this technology in GB, and the joint Western HVDC Link project.

It is important that any changes to the System Owner-Transmission Owner Code (STC) do not detract from the current effective working relationships between TOs and the SO. We would suggest that changes should be focused on providing for the new split SO and TO arrangements in England and Wales. We believe that the ability for existing TOs to retain their BETTA responsibilities should be clearly maintained through this process and the separated NGET TO business should hold the same obligations as the existing Scottish TOs. In addition, the role the Scottish TOs have to control their own infrastructure in emergencies must be retained, including network resilience and black start capabilities. These same responsibilities need to be able to be delivered by the NGET TO going forward. In an environment which is seeing unprecedented investment in the GB transmission network, we believe that it is important that TOs continue to work together and that this relationship is not jeopardised by giving too much responsibility to the SO beyond its core capabilities.

Effective business separation measures proportionate to the level/risk of conflict involved

Any business separation provisions should be appropriate to the nature of conflict or risk involved. As there are a number of conflicts which could arise from the evolving role of the SO, it is our view that the separation provisions should be strict. For example, the SO currently may be seen to have the ability to favour its TO business when preparing its Network Options Assessment (NOA) report by supporting non-competed options within NGET’s transmission area. Conflict mitigation arrangements must be proportionate and appropriate to manage this risk.

The separation of the SO and TOs in Scotland has over time proven to be an excellent working model. Customers have benefitted from close working relationships between TOs and the SO and the ability of the TOs to contribute to technical debate about the transmission network, informing both the Regulator and Government of system risks.

The future role of the Distribution System Operator

We agree with Ofgem’s proposals that a greater level of engagement and co-operation is required between the SO and DNOs. We have been leading on this issue for some time as demonstrated, for example, by our innovation in accelerating renewable connections (ARC) project, and work we have

Ochil House, 10 Technology Avenue, Hamilton International Technology Park, Blantyre, G72 0HT

Telephone: 0141 614 0008

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done with our DNO business to develop proposals for an improved Statement of Works process and Connection Queue management.

The next few years will see changes in the generation mix towards greater volumes of new smaller scale, intermittent sources of energy, and changes in the demand mix resulting from Electric Vehicles and electric heating, all of which will place greater emphasis on the need to consider the system as a whole and to ensure there is sufficient flexibility to manage it. Whilst the SO will be a key player, it is important that the future role of Distribution Network Operators (DNOs) is also considered as part of this wider role. As the SO will work with TOs and DNOs to define roles across the T-D interface, we expect further work will be required to ensure that appropriate licence obligations are placed on the SO to facilitate a Distribution System Operator regime and any other outcomes from the BEIS/Ofgem Call for Evidence on a Smart, Flexible Energy System.

Implementation timescales

The proposal to introduce full legal separation of the SO by April 2019 is practical as it is vital that separation is fully in place before the second transmission price control strategy is implemented.

However, we do wish to highlight that there are factors which may result in a delay to this proposal, such as the splitting of NGET's asset base and financial liabilities. It will be complex to split the RIIO-T1 price control funding as it includes existing financial arrangements between the SO and the TO. We would welcome further clarity to ensure that any potential delays are managed in advance.

Please do not hesitate to contact me should you have any queries in relation to our response. We have addressed the questions posed in the above consultation in Appendix 1.

Yours sincerely,



Alan Kelly
Transmission Commercial and Policy Manager
Network Planning and Regulation

Ochil House, 10 Technology Avenue, Hamilton International Technology Park, Blantyre, G72 0HT

Telephone: 0141 614 0008

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Appendix 1: Response to Consultation Questions

Chapter: One

No Questions

Chapter: Two

Question 1: What are your views on our proposed objectives for the SO (set out in paragraph 2.1)?

The proposed objectives for the SO are broadly in line with our expectations and the majority are objectives which the SO currently fulfills. It is important going forward that clear roles and responsibilities should be mapped out in detail to ensure that parties are clear as to what is expected of them going forward. The facilitation of competitive markets, whole system and competition in networks must strike the right balance of leadership and service provision to ensure the objectives are achieved for the benefit of GB consumers overall.

The SO-TO arrangements established through the BETTA regime in 2005 have worked well for GB consumers and it will be important that these arrangements are not undermined in the course of separating the SO and TO in England and Wales. At the time of developing the BETTA arrangements, debate focused on the extent of the SO role and the concept of a “shallow” or “deep” SO. In summary this relates to where the following roles are held:

1. purchase and call-off of balancing services
2. determining the real-time configuration of the transmission system
3. switching the transmission system
4. transmission system investment planning
5. construction of new transmission system assets; and
6. transmission system maintenance

Ultimately, a “shallow” SO was established taking responsibility for the first two activities with the remaining functions falling to the TOs. The BETTA roles and relationships are predicated on partnerships and close working relationships between the SO and TOs.

In our view the current working relationships between TOs and the SO are effective, and it is therefore important that any changes to the System Owner-Transmission Owner Code (STC) are minimised, and are limited to providing for the new split SO and TO arrangements. The role of existing TOs to retain their BETTA responsibilities must be clearly maintained through this process, and the separated NGET TO business should hold the same obligations as the existing Scottish TOs. In addition, the Scottish TOs ability to control their own infrastructure in emergencies must be retained, including network resilience and black start capabilities. These same responsibilities need to be delivered by the NGET TO going forward. In an environment which is seeing unprecedented investment in the GB transmission network, we believe that it is important that TOs continue to work together and that this relationship is not jeopardised by giving too much responsibility to the SO beyond its core capabilities.

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We also agree that the SO needs to work more closely with distribution network companies to ensure that individual issues or system needs are looked at as part of the whole picture rather than solely from a transmission perspective. Taking a whole system view is more likely to yield solutions that are efficient and deliver consumer benefit. We have been leading on this issue for some time as demonstrated, for example, by our innovation in accelerating renewable connections (ARC) project, and work we have done with our DNO business to develop proposals for an improved Statement of Works process and Connection Queue management.

As the NOA process will identify transmission projects that are likely to meet the criteria for competition, it is imperative that Ofgem also listens to incumbent TOs who may have additional information which has not been considered by the SO. As mentioned above, it is crucial that roles and responsibilities are mapped out so that it is clear the SO does not have too dominant a position in terms of determining which projects are competitively tendered, as this may allow the SO to selectively choose projects for competitive tendering which are not within NGET's licence area.

We note that paragraph 2.66 of the consultation states:

'...the SO will need to take the lead on certain options (e.g. cross regional solutions, alternative build solutions....'

We would welcome clarification on this point as to whether 'alternative build solutions' is the same as 'non-build' solutions.

As mentioned in our introduction, TOs have a 'coordinated' statutory duty which includes adhering to licence and STC obligations. Our successful track record in delivery of joint projects in the period since BETTA confirms that this has worked effectively to date. Therefore, we do not agree that the SO should necessarily take the lead on 'joint TO' projects, but should provide a co-ordination role.

Paragraph 2.67 states that the SO would undertake early development work for SO-led options. We believe that this should not extend to joint TO projects for the reasons mentioned above.

Question 2: What are your views on our expectations for how the SO should seek to achieve these objectives?

We agree with paragraph 2.7 that Ofgem may need to impose new licence obligations to reflect the new role of the SO. However, such obligations should only be imposed where there is a risk to either the consumer or other TOs, as otherwise this would be an additional administrative burden for Ofgem and National Grid.

In our view the current working relationships between TOs and the SO are effective, and it is therefore important that any changes to the System Owner-Transmission Owner Code (STC) are minimised, and are limited to providing for the new split SO and TO arrangements. NGET's TO should have identical roles and responsibilities as the existing TO Parties to the STC. NGET has already been proactive in seeking our views on our experience of delivering STC obligations and we welcome the approach from NGET that intends to adopt STC procedures to govern their SO-TO relationship wherever possible.

We look forward to continuing to engage with NGET and Ofgem informally over the coming months as requirements for other policy areas become clear. For example, once the outcome from the recent

joint BEIS/Ofgem Call for Evidence on Flexibility is published, there may be a requirement to implement obligations on the SO to ensure that an appropriate framework is in place with potential Distribution system operators.

Ofgem states that it is not intending to re-open the RIIO-T1 settlement as part of this process. However, where the SO is being asked to carry out a new or increased role it will consider whether any changes to funding might be necessary. We agree with Ofgem's proposal that additional funding should be considered only where there is clearly a material increase in costs faced by the SO for additional activities beyond what was envisaged at the time of the RIIO-T1 settlement. The proposed objectives are largely consistent with what was expected at the time of the price control settlement and may not constitute new outputs. It is therefore important that the term "material" is defined as this is open to differing interpretations. We suggest that existing re-opener thresholds or similar proposals are utilised to provide National Grid with regulatory certainty. However, any additional costs should be approved by an independent company or Ofgem to ensure that the consumer is not funding additional facilities that are not required such as extra recreational facilities.

Question 3: Do you agree with our proposals for what licence changes are needed to support these objectives?

It is our view that it would be sensible to keep the licence conditions as high level as possible and provide any required detail within an associated guidance document. This will allow any future modifications to be made without having to undergo licence modifications which are more administratively burdensome.

We also note that NGET's existing revenue licence condition will require to be altered to ensure that it can recover any costs associated with the additional provisions which are not already accounted for in the T1 price control. Otherwise, the costs will require to be recovered in the first year of the next price control with a time value of money applied.

Question 4: What are your views on the extent to which we should set specific or general obligations for the SO?

We have no specific views to add on this point.

Chapter Three

Question 1: Do you agree that greater separation between NG's SO functions and the rest of the group is needed?

As National Grid's role as SO will evolve so that it is responsible not only for the day to day operation of the system, but also supporting the introduction of onshore competition in transmission, we agree that further separation between National Grid's electricity SO and TO functions may be in the interest of consumers and other GB TOs.

As a general principle, the extent of the proposed business separation provisions should be proportionate to the nature of conflict or risks involved. As there are a number of conflicts of interest which could arise from the evolving role of the SO, it is our view that provisions should be strict. For example, the fact that the SO has the ability to favour its TO business when preparing its NOA report by supporting non-competed options within NGET's transmission area represents a significant conflict.

Ochil House, 10 Technology Avenue, Hamilton International Technology Park, Blantyre, G72 0HT

Telephone: 0141 614 0008

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We agree that the establishment of a new company within the NG Group which would be licensed to undertake the SO functions for GB is appropriate, so long as appropriate and cost effective business separation measures are implemented. We agree that a move to a fully independent SO is not demonstrably in the interests of GB consumers at this time.

Question 2: What are your views on the additional separation measures we are proposing?

We broadly agree with the proposals. It is appropriate that the SO will be required to have its own separate Board in order to mitigate the real and perceived conflicts of interest involved. Furthermore, it is appropriate to have Sufficiently Independent Directors (SIDs) who can constructively challenge and help develop strategy.

The requirement for the TO and SO to have its own accounts, assets and financial ring fencing obligations is important and we support this proposal.

We agree that it would be appropriate for the TO and SO businesses to have their own dedicated teams of regulatory, legal, HR and other support functions. However, it may also be efficient for to be provided at a corporate level, subject to appropriate safeguards.

National Grid's proposal for its Warwick office, to effectively make it into two separate offices, is pragmatic as this will reduce any perceived conflicts of interest whilst not requiring consumers to bear the cost of funding two separate buildings. However, we would query whether it is sensible and efficient to create additional recreational facilities as proposed by National Grid, given the value of doing so and the likely costs involved.

Question 3: What are your views on our proposed approach for implementing these changes?

The proposed process for separating the licence and transferring assets is sensible. However, this may prove to be more challenging than anticipated. For example, the STC enshrines the principle that arrangements for securities and liabilities for TO capital investments are provided by the SO. Given that the legally separate SO will be able to levy charges from customers, this may provide the basis for an appropriate level of credit worthiness that would allow these contractual arrangements to be honoured.

As section 7A (Transfer of licences) of the Electricity Act 1989 allows a licensee to ask Ofgem to transfer all or part of an existing licence to another entity, we believe that the licensees can be transferred. However, the split of relevant T1 price control funding and financial positions (existing debt etc), may lead to a prolonged debate which will need to be reflected in the proposed timescales.

Chapter: Four

Question1: What are your thoughts on our proposed approach for implementing the proposed changes set out in this consultation?

As above.

Question 2: What further evidence should we consider in finalising our impact assessment of the proposals on the SO's roles and level of independence?

Ochil House, 10 Technology Avenue, Hamilton International Technology Park, Blantyre, G72 0HT

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We note that Ofgem has not yet assessed the cost estimates that National Grid have provided, and that it may determine that some of these costs are not allowed.

At paragraphs 1.12 to 1.16, it is stated that National Grid can recover costs which are reasonable and have been incurred efficiently (outwith the T1 price control settlement). Earlier in the consultation at paragraph 2.72, Ofgem also states that additional funding will only be considered where there is clearly a material increase in costs faced by the SO and the activity is beyond what was envisaged at the time of the RIIO-T1 settlement.

Whilst we agree in principle with the proposals, it is our view that a materiality threshold should be imposed for National Grid and stakeholders, as well as a regulatory mechanism to ensure consistency and transparency in the definitions of reasonable and efficiently incurred costs. This mechanism may be akin to the current price control re-openers.

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