

24 MARCH 2000

**PROPOSED DETERMINATION
BY THE DIRECTOR GENERAL OF ELECTRICITY
SUPPLY OF APPLICATION BY SCOTTISH POWER
PLC FOR APPROVAL OF RESERVATION OF
UPGRADE CAPACITY ON THE SCOTTISH
INTERCONNECTION**

Contents

	Page
1. Overview	1
2. Background	3
3. Consultation and Responses	7
4. The European Directive 96/92/EC	17
5. The Electricity Act 1989	21
6. Supplementary Arguments	30
7. Conclusion	31

Annex A List of Respondents

Annex B Extracts from EC Directive 96/92/EC

Annex C Conditions 3 and 3B of Part VI of ScottishPower's composite licence

1. Overview

- 1.1 This document is in response to the application made by Scottish Power plc (“ScottishPower”) on 22 April 1999 to the Director General of Electricity Supply (“the Director”) for approval of a reservation of 75 percent of the upgrade capacity in the Scottish interconnection until 2034 to its own Generation Division, which it regards as the undertaker of ScottishPower’s Wholesaling Business.
- 1.2 The document follows an Ofgem initial Consultation Paper on the subject published in September 1999.¹ A list of respondents is included in Annex A (copies of non-confidential responses have been placed in Ofgem’s library).
- 1.3 Having considered ScottishPower’s application, responses to the September 1999 Consultation Paper and further submissions from ScottishPower, this document indicates how the Director is presently minded to respond to the application. In summary, the Director is presently minded not to approve the reservation to ScottishPower’s Wholesaling Business of 75 percent of the upgrade capacity of the interconnector as requested in its application of 22 April 1999.
- 1.4 Chapter 2 provides background information, including a summary of the regulatory regime. Chapter 3 provides a summary of responses to the September 1999 Consultation Paper, including a summary of ScottishPower’s response (in respect of which ScottishPower has claimed confidentiality, as it had previously with regard to its application). An evaluation of the arguments made by ScottishPower in its application is covered in chapters 4, 5 and 6. Chapter 4 evaluates issues relating to the European Directive 96/92/EC (“the Directive”).² Chapter 5 refers to the Electricity Act 1989 and factors raised in the December 1998 determinations. Chapter 6 discusses other arguments made in ScottishPower’s application, and Chapter 7 provides preliminary conclusions.

¹ ScottishPower’s application for reservation of upgrade capacity on the Scotland-England Interconnector, Ofgem, September 1999.

² “Directive 96/92/EC of the European Parliament and of the Council of 19 December 1996, concerning common rules for the internal market in electricity”.

1.5 Ofgem seeks views on the proposed determination as set out in this document. Responses are invited by 28 April 2000. Following receipt of the responses, Ofgem will issue a statement of the Director's determination with respect to ScottishPower's application.

1.6 Responses should be sent to Grant McEachran.

Grant McEachran

Ofgem

70 West Regents Court

Glasgow

G2 2QZ

Tel: 0141-331-2678

Fax: 0141-331-2777

E-mail lmartin@ofgem.gov.uk

Ofgem proposes to place all responses in the Ofgem library.

2. Background

Regulatory regime

- 2.1 The office of Director General of Electricity Supply (“the Director”) is created by the Electricity Act 1989 (“the 1989 Act”). The Director’s duties, functions and powers are set out in legislation, primarily the 1989 Act. These duties include the duty to promote competition in the generation and supply of electricity, to act in a manner best calculated to secure that licensees are able to finance their licensed activities, to protect customers in respect of prices and continuity of supply, and to promote efficiency and economy on the part of persons authorised by licences to supply or transmit electricity. The Director exercises a range of functions under licences granted under the 1989 Act in relation to licensed operators.
- 2.2 The Director also has concurrent jurisdiction with the Director General of Fair Trading (DGFT) under the Fair Trading Act 1973 and the Competition Act 1980. With effect from 1 March 2000, the Director also has concurrent jurisdiction with the DGFT under the Competition Act 1998 to enforce the terms of that Act.
- 2.3 ScottishPower has been granted a generation, transmission and a public electricity supply licence under the 1989 Act which, unlike licences in England and Wales, are held in a composite licence structure. The individual licensed elements of generation, transmission and public electricity supply are undertaken by separate internal trading divisions which have no legal personality or standing. The consequence of this is that ScottishPower is unable to contract with itself in any way that is legally meaningful (as recognised by ScottishPower in a letter dated 18 October 1999 responding to Ofgem’s September 1999 Consultation Paper).
- 2.4 Section 9(2)(b) of the 1989 Act places a duty on the holder of a transmission licence to facilitate competition in the supply and generation of electricity. Section 9(3) of the Act applies that duty in Scotland, to ScottishPower and Scottish and Southern Energy plc (“Scottish Hydro-Electric”) as a duty to make its transmission system available to its competitors on terms which neither prevent nor restrict such competition.

- 2.5 The Scotland-England interconnector comprises the Scottish interconnection (“the Interconnector”) (north of the border) which forms part of ScottishPower’s transmission system, and the England and Wales interconnection (“E&W interconnection”) (south of the border) which in 1990 was leased by the National Grid Company (“NGC”) to ScottishPower and Scottish Hydro-Electric, who assumed by contract NGC’s obligations under Section 9(2)(b).
- 2.6 Condition 3B of Part VI of ScottishPower’s composite licence sets out the requirements on that company to offer terms for use of the Interconnector. Condition 3B.1 provides (in summary) that, on application made by any person, the licensee shall (except where paragraph 2 of that Condition applies and subject to paragraph 7 of that Condition) offer to enter into an agreement for use of the Interconnector to transport electricity in such quantities and for such periods as may be specified in the application, specifying the charges for use of the Interconnector and containing such further terms as may be appropriate.
- 2.7 Paragraph 2 of that Condition makes provision for the Director, on the application of any person entitled or claiming to be entitled to an offer of terms for use of the Interconnector, to determine whether there is insufficient capacity to accommodate the applicant’s requirements. It requires the Director to have regard to the part of the capacity of the Interconnector already contracted to persons other than the licensee and its affiliates and “the part approved by the Director as being reserved to the licensee and affiliates and related undertakings of the licensee for the purpose of the Supply Business, Second Tier Supply Business and Wholesaling Business” (all as defined in Part II of the composite licence).
- 2.8 Conditions 3 and 3B relate to the basis of charges for the Interconnector. Condition 3B.5 states that the Licensee shall have regard to the benefit or future benefit to be obtained by the Licensee or any other person as a result of increase in the capacity of the Interconnector in consequence of an upgrade. Condition 3B.7 of Part VI of the composite licence requires inter alia that any agreement should not breach any statutory or licence requirements. (Conditions 3 and 3B are set out in full in Annex C to this proposed determination).

ScottishPower's application and previous determinations

- 2.9 On 10 August 1998, ScottishPower's Transmission Business asked the Director to approve the reservation (until 2034) to ScottishPower's Generation Wholesale Division ("GWD") of the whole of the Interconnector capacity to which ScottishPower's Transmission Business was contractually entitled, that is, 54 percent of the pre-Vesting capacity and 75 percent of upgrade capacity.
- 2.10 In December 1998 the then Director made determinations³ regarding the application made by ScottishPower, along with separate and earlier applications made by British Nuclear Fuels plc and National Power Co-Generation (Trading) Ltd. He determined that in view of the limited extent of competition in Scotland at the time, and ScottishPower's duty to make the Interconnector available to its competitors on terms which neither prevent nor restrict competition, and the Director's duty to promote competition in generation and supply, it would not be appropriate for him to approve ScottishPower's request to reserve to its GWD all the Interconnector capacity available to its Transmission Business.
- 2.11 The Director also said that as ScottishPower had not made separate applications to reserve pre-Vesting capacity or upgrade capacity, he had not come to any conclusions on such hypothetical applications. It was therefore open to ScottishPower to make such applications.
- 2.12 As noted above, on 22 April 1999, ScottishPower applied to the Director for approval of a reservation of 75 percent of the capacity of the first and second upgrade of the Interconnector until 2034 to its GWD, which it regards as the undertaker of ScottishPower's Wholesaling Business.
- 2.13 The application is made for reservation regarding upgrades in the capacity of the Interconnector, which are in addition to the 850 MW of nominal capacity in place at Vesting. The first upgrade, the addition of 750 MW of nominal capacity, was commissioned late in 1993, though total Interconnector operation is limited to an average nominal capacity over a year of 1340 MW rather than 1600 MW (ie. 850 MW pre-Vesting capacity

³ "Determinations by the Director General of Electricity Supply of applications by British Nuclear Fuels plc, National Power Co-Generation (Trading) Limited and ScottishPower plc in respect of access to capacity on the Scotland-England Interconnector", OFFER, December 1998.

and the 750 MW upgrade) until completion of the North Yorkshire line within NGC's system. The second upgrade, a further 600 MW of nominal capacity, is not yet fully committed but could be completed and commissioned on completion of the North Yorkshire line. The application does not relate to the 850 MW in place at Vesting or any further upgrade beyond 2200 MW.

- 2.14 By agreement between ScottishPower and Scottish Hydro-Electric, the first and second upgrades of the Interconnector have been and will be financed 75 percent by ScottishPower and 25 percent by Scottish Hydro-Electric. ScottishPower's application therefore relates to a nominal capacity of 75 percent of 1350 MW in total i.e. to a nominal capacity of 1012.5 MW. However, as indicated above, the actual availability of the Interconnector varies considerably according to operating conditions on either side of the border. This availability is estimated for the year ahead and determined from time to time by NGC and ScottishPower in accordance with the British Grid Systems Agreement (to which Scottish Hydro-Electric is also a party).
- 2.15 ScottishPower's application was made with respect to provisions in ScottishPower's licence. The Director has not been asked to determine any matters in respect of the licence held by Scottish Hydro-Electric. However, like considerations may apply in respect of any applications of a similar nature made by Scottish Hydro-Electric.

3. Consultation and Responses

The September 1999 Consultation Paper

- 3.1 ScottishPower submitted its application for approval of reservation of upgrade capacity in the Interconnector on 22 April 1999 and asked that its application be treated as confidential and should not be published. The application was not published but its terms were summarised in the September 1999 Consultation Paper. ScottishPower has made no objection to the content of the summary.
- 3.2 The September 1999 Consultation Paper summarised the arguments presented by ScottishPower in support of its application as follows:
- a) ScottishPower and the Director are bound to comply with the Directive;
 - b) the Directive states that “the use of Interconnectors shall be determined on the basis of criteria which must be objective, published and applied in a non-discriminatory manner” (Article 8, paragraph 2);
 - c) to ensure a non-discriminatory approach, any application for a reservation of Interconnector capacity in favour of ScottishPower (GWD) must be treated by the Director in the same way as ScottishPower’s Transmission Business would treat an application for contracted capacity made by a third party;
 - d) the criteria adopted by ScottishPower in dealing with application for use of the Interconnector must also be adopted by the Director;
 - e) the duty of the Director to promote competition relates to the whole of Great Britain and not any part (eg. Scotland), and is best served by ScottishPower’s use of the Interconnector; and
 - f) where sufficient Interconnector capacity is not available, a party paying for an upgrade will be able to obtain the use of the upgrade capacity. ScottishPower’s Wholesaling Business has financed the upgrades to the Interconnector and is entitled to the same rights as any generator who has done so.

3.3 The September 1999 Consultation Paper also summarised as follows a number of factors which in ScottishPower's view should be taken into account in the Director's assessment of its application:

- a) ScottishPower was privatised in 1991 on the basis of access to expanded Interconnector capacity and has invested in the upgrades. ScottishPower's GWD has underwritten capital expenditure for the upgrade works in Scotland and charges NGC for upgrade works in England. ScottishPower's GWD pays charges to ScottishPower's Transmission Business and NGC and these are set to increase with the upgrade.
- b) The export business is a significant component of ScottishPower's GWD business, accounting for a substantive element of sales from ScottishPower's own generating stations. The removal of these sales would substantially reduce GWD's profits and affect the continued viability of ScottishPower's power stations.
- c) In order to maximise utilisation of the Scottish Interconnector, ScottishPower has:
 - i) extended and is continuing to extend the lives of Longannet and Cockerzie;
 - ii) continued to spend on its stations; and
 - iii) secured a portion of coal requirements for several years ahead with Scottish coal producers.
- d) For many years increasing exports has been a major element of ScottishPower's business plans, and as such has been communicated to investors, analysts, the Regulator and others. Any material restriction on ScottishPower's ability to export would be damaging to its business prospects.

3.4 The September 1999 Consultation Paper sought views on ScottishPower's application in the context of the issues summarised above and views on the specific questions quoted below.

Third party responses to the September 1999 Consultation Paper

- 3.5 Third party responses to the September 1999 Consultation Paper are summarised in this section, with the exception of one confidential response.
- 3.6 As to the general issues, Scottish Hydro-Electric suggested that Transmission Businesses do not make investments unless sources of income are assured, that those parties who invest in assets should have secure rights over use, and that it would create regulatory uncertainty if Ofgem was to depart from these principles. London Electricity plc and NGC argued similarly, with NGC adding the caveat that, to the extent that a party with rights is not using an Interconnector, there should be a clearing mechanism to allow others to use and pay for spare capacity.
- 3.7 British Energy plc ("British Energy") argued that any reservation of capacity to ScottishPower would be incompatible with non-discriminatory access to competitive markets, which should be secured by early establishment of an independent operation of the Interconnector, with capacity allocated and charged for under market-driven arrangements. PowerGen UK plc ("PowerGen") and TXU Europe Power and Energy Trading BV expressed similar views. Enron Europe Limited and several individual respondents were against a reservation to ScottishPower, and in favour of independent operation of the Interconnector, but did not favour an auction of Interconnector capacity, at least until the market was truly competitive. British Gas Trading Ltd ("BGT") wished to see access resolved within the context of a Great Britain market and commented that an independent Transmission business would, as a minimum, have invited other parties to express their interest in additional Interconnector capacity.
- 3.8 The Major Energy Users Council ("MEUC"), the Chemical Industries Association ("CIA"), BOC Gases ("BOC"), Caledonian Paper plc, Yorkshire Electricity plc ("Yorkshire"), Northern Ireland Electricity plc ("NIE"), RJB Mining (UK) Ltd, the Scottish Renewables Forum and Acharn Hydro Ltd in various ways were against barriers to trade.
- 3.9 The response made in confidence has also been reviewed. The significant issues have been summarised in Ofgem's published papers or are covered in the responses made by other respondents. To the extent that these issues are not in the public domain and are not so

covered, they have not influenced the proposed decision. Responses to the specific questions in the consultation paper are summarised below.

3.10 The extent to which ScottishPower's Wholesaling Business and a third party should have the same rights to full use of an interconnector when paying for that upgrade.

Scottish Hydro-Electric suggested that long-term contracts should confer full rights, for the GWD and third parties alike; British Energy, CIA, BOC and the Scottish Renewables Forum suggested that the GWD should have the same rights only if constituted as a demonstrably separate business; PowerGen suggested upgrade investments should be made by the Transmission Business so as to ensure a competitive market; NIE wished to see full access from England into the Scottish market; and MEUC suggested that no party should have exclusive rights.

3.11 The appropriate criteria to be used by ScottishPower's Transmission Business to assess an application for use of the upgrade capacity of the Interconnector by a third party and, if different, the appropriate criteria to be used by the Director in determining a reservation by ScottishPower's GWD.

Scottish Hydro-Electric suggested that, where capacity had been fully assigned to any user paying in full for an upgrade, the Transmission Business could not allocate any of that capacity to a new applicant. British Energy suggested criteria which included the furtherance of competition, full consultation, and that upgrades should be carried out by the Interconnector business and paid for by "carriage contracts"; PowerGen and NIE recommended a capacity auction; BGT and Yorkshire suggested the upgrade process should allow anyone to express an interest and should demonstrate non-discrimination; and the Scottish Renewables Forum suggested that it was hardly open to the Director to apply criteria adopted by ScottishPower about which he had already expressed reservation, and suggested that, where participants differed significantly, a non-discriminatory approach might seek to redress the balance.

3.12 The extent to which the fact that part of the capacity being sought for reservation already exists has a bearing in distinguishing the application from that made by a third party.

Scottish Hydro-Electric suggested that there was essentially no difference as in its view the reservation sought to formalise existing inter-business arrangements which underpinned the construction of the upgrades; British Energy suggested that all capacity should be available under transparent, non-discriminatory rules; and PowerGen, British Gas Trading, Yorkshire, NIE and MEUC said this was irrelevant.

3.13 Whether, how and to what extent ScottishPower's GWD can be said to have underwritten the costs of each Interconnector upgrade, the first to 1600 MW and the second to 2200 MW.

Scottish Hydro-Electric suggested that this had been reflected by the exclusion from transmission price controls of revenue from Interconnector upgrades, and, to the extent that the GWD had agreed to pay for the upgrade assets, it could be considered to have underwritten the costs of both the Interconnector upgrades; British Energy commented that there had been no public consultation and no opportunity for others to participate; PowerGen, MEUC, CIA and the Scottish Renewables Forum said that the extent of any underwriting was unclear; BGT drew a distinction between the investment of capital, recorded within the accounts of the GWD, and the regular payment of capacity charges; Yorkshire suggested that the present arrangement was little different from the payment of annual charges by a PES supply business to its distribution business; and BOC recalled that ScottishPower's use of system charges had risen due to delay in upgrading the Interconnector.

3.14 The extent to which any investment made by ScottishPower's GWD in generation facilities should be a relevant factor to take into account.

Scottish Hydro-Electric suggested that investment in generation would only be carried out on the basis of long-term access to the market, and that increased access to the English market through an upgraded Interconnector was signalled in the Prospectus of the Scottish companies; PowerGen, BGT, Yorkshire, NIE, MEUC and BOC suggested that any generation investment was irrelevant, for (as was said by PowerGen) all generation was subject to competitive pressures from new entry; and the Scottish Renewables Forum suggested that it

was inconsistent of ScottishPower to argue within its application for its business and that of a third party to be treated equally in respect of the treatment of its application by the Director and then to seem to argue for special treatment in respect of its own power stations.

3.15 The extent to which a share of the upgrade Interconnector capacity of ScottishPower's Transmission Business should be available to any party either through the same charges or an auction mechanism being offered to all parties.

Scottish Hydro-Electric suggested that the Transmission Business did not have any upgrade capacity to make available to third parties, except in respect of the potential upgrade from 2200 MW to 2500 MW; British Energy, PowerGen and CIA suggested that all the Interconnector capacity should be available through non-discriminatory market-priced arrangements; and BGT, Yorkshire, NIE and MEUC suggested that a non-discriminatory process should be adopted for the sale of what BGT called contract carriage rights, subject to a rationing process such as an auction if the available capacity was over-subscribed.

3.16 The extent and duration of any reservation of the capacity of Interconnector upgrades or pre-Vesting Interconnector.

Scottish Hydro-Electric suggested that the duration of a reservation should correspond with the duration until 2034 of the on-going payment obligations to NGC, assuming that, if the GWD wished to terminate the agreement, there would be an early termination payment (unless another user was found); NIE suggested that any reservation should be limited to as few years as possible; and British Energy, PowerGen and MEUC suggested that there should be no long-term reservations unless (British Energy said) secured under market-related processes.

3.17 The extent to which the ending of the Nuclear Energy Agreement on or before April 2005 should be taken into account.

Scottish Hydro-Electric, PowerGen, NIE, MEUC and the Scottish Renewables Forum suggested that this was not relevant; BGT suggested that this was not relevant, provided all parties had access to the England and Wales market; Yorkshire suggested that any reservation to ScottishPower should end at the same time as the Nuclear Energy Agreement;

and British Energy suggested that this issue was of great importance, and that the Interconnector arrangements should not preclude open competition in 2005.

3.18 The extent to which access to the capacity of the Interconnector upgrades has been open to competition and should be opened to competition in the future.

Scottish Hydro-Electric commented that there had been little demand from third parties and no willingness to fund upgrades, and that the proposed 2500 MW upgrade afforded an opportunity to test the market; British Energy, PowerGen, Yorkshire, MEUC, CIA and BOC commented that the full Interconnector capacity needed to be open to competition, and should remain so; and BGT questioned whether sufficiently competitive processes had been adopted to date.

3.19 The extent to which any long-term reservation of Interconnector capacity is conducive to efficiency and economy in the supply and transmission of electricity.

Scottish Hydro-Electric suggested that long-term capacity rights for parties who had invested were conducive to new entry by reducing risk, whereas uncertainty regarding access was a barrier to entry; British Energy, PowerGen, MEUC, CIA and BOC suggested that reservations were not conducive to efficiency and economy until (British Energy said) an open and competitive market was established; BGT was not against long-term reservations, provided these had been established by open and competitive processes, and any spare capacity was made available in a secondary market; and NIE suggested that reservations should not be allowed simply to protect generation interests from competition.

3.20 The arrangements most conducive to appropriate investment in additional Interconnector capacity.

Scottish Hydro-Electric suggested that the choice was between guaranteed access to generators who guaranteed the costs, and recovery of the costs from regulated transmission charges; British Energy suggested that appropriate arrangements would include incentivising a transmission or Interconnector Business to facilitate competition, development of price signals across constraints, and longer-term development of Great Britain-wide trading arrangements; PowerGen suggested that market forces could signal the need for upgrades; BGT and MEUC suggested that Interconnector constraints should be treated like any other transmission constraints; and NIE suggested that Interconnector investment should be

financed by allowing transmission companies a reasonable rate of return on such investment.

3.21 Whether all Interconnector capacity, including the upgrades, would be better encompassed by price controls.

Scottish Hydro-Electric suggested that the option of allowing upgrade expenditure within the price controls required further discussion and clarification; and British Energy, Yorkshire, MEUC and BOC said “yes”.

3.22 The extent to which the obligation to provide third party access to the Interconnector falls on ScottishPower or a part thereof.

Scottish Hydro-Electric suggested that this was a transmission licence obligation which appropriately fell on the Transmission Business; British Energy said this fell “on ScottishPower as current owner and licensee”, as did MEUC and BOC; PowerGen and BGT wished to see this obligation transferred to an independent Interconnector operator; and NIE suggested that this issue, like some others discussed above, required full compliance with the Directive.

ScottishPower’s response

3.23 As explained above, ScottishPower had sought confidentiality and non-publication in respect of both its application for reservation of Interconnector upgrade capacity and its response to the September 1999 Consultation Paper. As such, the Director has not published ScottishPower’s application or response to the September 1999 Consultation Paper. The summary of its application contained in the September 1999 Consultation Paper is reproduced above. ScottishPower’s response to the September 1999 Consultation Paper is summarised in this section.

3.24 ScottishPower, in the introduction to its response to the September 1999 Consultation Paper, stated that it sought non-discriminatory treatment of its GWD and the application to ScottishPower of the criteria set out in its licence for assessment of requests for reservation by third parties, and expressed its view that issues such as the reform of trading arrangements were not relevant to the determination.

- 3.25 In ScottishPower's view other key issues were that ScottishPower had paid for an upgrade to the capacity since Vesting and had contracted for a further upgrade, that its GWD (as for any other generator) needed commercial certainty of access to the Interconnector and that the benefits of greater interconnection – including greater competition in England and Wales – had been recognised in the Prospectus and subsequently.
- 3.26 ScottishPower's specific arguments included the following:

"... the criteria set out in the Directive, Act and Licence as applicable to third parties are to be applied to ScottishPower. Otherwise the regime effectively discriminates as between ScottishPower and third parties. As noted in [ScottishPower's application] there are a variety of factors that ScottishPower as Transmission Licensee, and therefore the Director, must take into account."

"We have responded in our Application to all those matters which in our view, as a matter of law, are relevant to our Application under the present arrangements. We have also explained to the Director why other factors are irrelevant to the determination of the Application. By introducing such criteria the risk is that the Application is turned into a regulatory review and as a means of procuring change. These changes should either be procured by licence modification or by legislation."

"We record our disagreement with the unsupported assertion [in the consultation paper] that 'there has been no robust separation between the relevant Businesses of ScottishPower'. In any case the presence or absence of such separation is not relevant to the Application and the Director is not entitled to take it into account."

"The scale of investment required in upgrading the Interconnector requires, as a necessity, firm knowledge that a customer is actually willing to pay. We do not believe that the costs of constructing additional capacity would be acceptable in financial terms unless those costs were incurred on the clear understanding that such additional capacity would actually be used and paid for on a long term basis. The costs of financing such capital expenditure would without such an understanding be difficult to justify."

"There is significant support for the principle of contract carriage i.e. that parties who invest in new capacity should benefit in that capacity.... We would not therefore be able to agree with BNFL's comments cited at page 15 [of the consultation paper] that the benefit

envisaged in the May 1991 Privatisation Prospectus from upgrades were the increased Interconnector charges obtained [sic] by the Transmission Business from the upgrade."

3.27 ScottishPower's responses to the specific questions in the September consultation paper added in two respects to the points quoted above. As regards the "underwriting" of the costs of each Interconnector upgrade it stated:

"..... an Inter-Business Agreement was put in place by ScottishPower in order to demonstrate that the Generation Wholesale Business is paying for the costs of the Interconnector capacity which it uses. Further, the regulatory accounts demonstrate that the costs of the Interconnector capacity are met by the Generation Wholesale Business, a position not challenged by the Director. We are not aware of any objective basis for regarding such evidence as inadequate. Up until this date ScottishPower's Generation Wholesale Division has underwritten the Transmission Division's costs in upgrading the Interconnector....."

3.28 As regards ScottishPower's investment in generation facilities it stated:

"..... In the Application to the Director, we highlighted the material contribution of exports through the Pool to the profitability of the Generation Wholesale Business. Any threat to this must have a knock-on effect on decisions about the value of future investments and cause us to reassess the value of previous investments in the plant used for exporting. We see this as a relevant consideration both because it affects Scottish Power's ability to be and remain competitive and because of the Director's duty under section 3(1) (b) of the Act (as construed to be consistent with Scottish Power's duty as Transmission licensee) to secure that licence holders are able to finance the carrying on of their authorised activities. Further we do not believe that it is right for the Director to acquiesce in the investment decisions, knowing their dependence on access to Interconnector capacity, then deny such access when the need for certainty on this point arises by virtue of his statements...."

4. The European Directive 96/92/EC

Background

- 4.1 The Director has obligations under the Treaty of Rome (as amended) ("EC Treaty") as an emanation of the UK State. Of particular relevance is Article 10 (formerly Article 5) which obliges Member States:
- i) to take all appropriate measures to ensure the fulfilment of their obligations to facilitate the achievement of the Community's objectives; and
 - ii) to abstain from any measure which could jeopardise the attainment of the objectives of the EC Treaty.
- 4.2 EC directives are binding on the Member States (and emanations of the Member States) to whom they are addressed as to the results to be achieved, although it is left to the national government to choose the form and method of implementation.
- 4.3 Case law also indicates that many utilities are emanations of the State insofar as they provide a service to the public, enjoy special statutory powers to enable them to do so and do so subject to control (for example by licence) of the State. ScottishPower will be subject to a directive to the extent that it is an emanation of the State. ScottishPower accepts in its application that it is subject to the terms of the Directive.

Requirements of the Directive

- 4.4 The Directive lays down the minimum requirements to be satisfied for *inter alia* electricity transmission systems to be compatible with the internal market in electricity and, therefore, with European law.
- 4.5 As regards transmission systems (including interconnectors) the Directive requires the transmission system operator to be at least managerially independent and to publish objective, transparent and non-discriminatory criteria for use of the Interconnector.

- 4.6 In particular, Article 7.1 of the Directive requires Member States or transmission system owners to designate a transmission system operator. Article 7.6 of the Directive requires that, unless the transmission system operator is independent from generation and distribution activities, it shall be independent at least in management terms from other activities not relating to the transmission system. Article 7.5 of the Directive requires that the transmission system operator shall not discriminate between system users, particularly in favour of its subsidiaries or shareholders.
- 4.7 Article 8.2 of the Directive requires criteria for use of Interconnector to be objective, published and applied in a non-discriminatory manner. Approval by the Member State of the criteria to determine use of interconnectors is not mandatory. However, the criteria must set out clearly defined procedures for access that can be applied in a manner which does not discriminate in favour of one user over and can be administered by an entity which is at least managerially separate from that of any user.
- 4.8 Articles 16 and 17 set out further provisions of access to the system. The full text of Articles 7, 8, 16 and 17 are set out in full in Annex B to this proposed determination.

Status of Implementation

- 4.9 The Directive had an implementation date of 19 February 1999. The Directive has yet to be transposed fully into UK law. Ofgem has issued proposed licence modifications in a notice issued in February 2000, under Section 11(2) of the 1989 Act, as a step towards achieving full compliance with the Directive. Further action to achieve full compliance is required.
- 4.10 At present, ScottishPower's existing Generation and Transmission businesses share premises and common services, including regulation, strategic planning and operational control, and report to the same Board Member. Although ScottishPower's Transmission Business presently undertakes some of the functions that would be undertaken by a transmission system operator, a transmission system operator whose functions are at least managerially separate from ScottishPower has not been formed. As such, a transmission system operator compliant with the Directive has yet to be established in Scotland.

Director's Duties in Regard to the Directive

- 4.11 Although the Directive leaves matters of detailed implementation (form and method) to the Member State, a fundamental objective is expressed in Recital 12 namely "... *whatever the nature of the prevailing market organisation, access to the system must be open in accordance with this Directive*".
- 4.12 The Director (as an emanation of the State) is under a duty to act in compliance with the terms of the Directive and in a manner which achieves the result laid down by the Directive. The Director has a positive duty not to act where the action contemplated would have an effect significantly contrary to the terms or the objectives of the Directive. It is, therefore, clear that the Directive not only must be complied with in terms of formal implementation but should be complied with also in respect of the actions and measures taken by the Director pending its formal implementation. The Director cannot deviate from a path leading to compliance; he should avoid measures which may endanger the result prescribed by the Directive being achieved.
- 4.13 The Directive has not been fully transposed. Notwithstanding this certain elements of the Directive are sufficiently clear, precise and unambiguous to have direct effect and form part of the legal framework against which the Director must discharge his duties. As the Directive's requirements are binding upon the State and emanations of the State including the Director, the Director has had to consider ScottishPower's application in light of the requirements of the Directive. For the Director to accede to this request would mean that a significant part of the upgrade capacity of the Interconnector would be denied to third parties. In effect this would amount to an exclusion of 75 percent of the upgrade capacity of the Interconnector from the ambit of the Directive until 2034.

Non-discriminatory Criteria

- 4.14 Under the arrangements for the Interconnector, ScottishPower is required to issue Access and Allocation Codes for the E&W interconnection, which are required to be in compliance with ScottishPower's licence obligations, including those in regard to the Interconnector. The Director considers that the present version of the Access and Allocation Codes do not meet the objectives of the Directive. Furthermore, the Codes have not been issued by a

transmission system operator that is at least managerially separate from ScottishPower's GWD as required by the Directive.

Conclusion

- 4.15 The Director, in the discharge of his duties, is obliged to have regard to European Law. He should not act in a way that frustrates the purpose of the Directive as this would be unlawful. It is the preliminary view of the Director that to grant ScottishPower's application would be incompatible with his obligations under the Directive as an emanation of the State, in so far as it would amount to the granting of privileged right of access to the Interconnector in circumstances where the conditions laid down by the Directive were not satisfied, and, would prejudice the achievement of the result required by the Directive.

5. The Electricity Act 1989

Background

- 5.1 Ofgem's September 1999 Consultation Paper discussed the background to ScottishPower's application, and referred to the October 1998 consultation and the Director's determinations of December 1998. The September 1999 Consultation Paper explained that the licence does not set a basis for assessing an application by ScottishPower for reservation of capacity to itself, and that paper referred to the possible considerations that had been outlined in the determinations of December 1998 which said, in relation to any future application by ScottishPower, at paragraph 4.33:

"It might be helpful for me to indicate that, as part of such an application, it would be important to clarify issues such as the precise extent to which ScottishPower or one of its businesses had in fact underwritten the costs and risks of the first and second upgrades; the terms and basis of Interconnector charging, including with respect to access by future competitors; and the extent of transferability of access rights. It might also be relevant to have regard to the present and prospective structure of the industry in Scotland; the extent to which there is or will be effective separation of Businesses by ScottishPower; and the extent to which competition and new entry have developed. The duration of the period for which any application might be granted could also have regard to potential changes in circumstances, particularly the ending of the Nuclear Energy Agreement in 2005 and the introduction of revised trading arrangements in England and Wales and in Scotland. In considering any application in the light of all these factors and other relevant considerations, I should expect great weight to be accorded to ScottishPower's statutory duty to make its transmission system available on terms which neither prevent nor restrict competition in supply and generation, and to my own duty to promote such competition."

- 5.2 The September 1999 Consultation Paper also quoted paragraph 6.21 of the determinations, which said, in relation to the application made by National Power:

"I would expect terms offered to future applicants to have regard to my comments and determination with respect to period of access for BNFL. That is, I would expect the terms to confirm access for an initial period until, say, March 2002, and to make provision for

revising terms for access thereafter in the light of revised trading and other arrangements as they develop over time.”

- 5.3 In this Chapter, the Director considers the application in the light of these statements and evaluates the arguments made by ScottishPower in its application regarding finance and competition in the context of ScottishPower’s treatment of access to its own GWD and third parties.

ScottishPower’s treatment of its GWD

- 5.4 ScottishPower submits in its application that ScottishPower’s GWD has underwritten the Transmission Businesses costs in upgrading the Interconnector. This is not substantiated in ScottishPower’s application.
- 5.5 ScottishPower makes reference to an unpublished agreement between its Transmission Business and its GWD completed on 16 April 1993, which was first notified to the Director on 10 August 1998. The agreement makes provision for GWD to pay annual charges to the Transmission Business which are intended to meet the annual costs (including capital charges) of the first Interconnector upgrade that was commissioned later in 1993.
- 5.6 The Director understands that the agreement subsists until the earliest of the date of expiry or earlier termination of (a) the Use of Interconnector Agreement (Scotland) 1991 or (b) the British Grid Systems Agreement or (c) the Use of System Agreement between the GWD and the Transmission Business of the same date. It appears that, in the event of termination or default, GWD would be liable only for the outstanding charges in respect of the year concerned. There is no reference to any bond or other form of guarantee.
- 5.7 The above points have prompted the Director to examine critically the argument that GWD of ScottishPower has underwritten the costs of the Interconnector upgrades. The Director is of the view that this argument has a number of difficulties as follows:
- a) The agreement to meet the costs of the first upgrade was not made until 16 April 1993, by which time most of the investment had been made, and had been underwritten by the Transmission Business until that date.

- b) Interconnector assets are shown only within the accounts of the Transmission Business, and in the Regulatory Accounts GWD does not show any significant commitment under operating or finance lease commitments. The Regulatory Accounts for 1997-98, for example, simply show an inter-business use of system charge of £16.9 million by the Transmission Business to the GWD, presumably for use of the transmission system (including the pre-vesting Interconnector) and the Interconnector upgrade.
 - c) While the inability of one of ScottishPower's businesses to enter into a legally binding contract with another of its businesses is recognised by both ScottishPower and the Director, this need not have precluded at least an accounting note of any underwriting of the Interconnector upgrade under ScottishPower's licence obligation to account for the assets, liabilities, reserves and provisions attributable to each separate business "as if it were carried on by a separate company." Such a note might have provided the type of evidence which in its application ScottishPower invited the Director to specify, and which the Director in paragraph 4.33 of the December 1998 Determinations invited ScottishPower to submit in order to substantiate its claims.
 - d) The agreement completed on 16 April 1993 makes no reference to the second Interconnector upgrade, in respect of which ScottishPower's Transmission Business has reported preparatory investment of £8 million in 1996/97, and has forecast the need for further investment of at least £30 million in about 2000/01, and ScottishPower has entered into additional arrangements with NGC.
- 5.8 The Director has supported the principle that companies that invest in new capacity that brings economic benefits should be appropriately remunerated for that investment. At present investment for upgrades is made by the licensed Transmission Business (though outside of that Transmission Business activities whose revenue is presently regulated under a price control), in respect of which the Director has a duty to secure the financing of licensed activities.
- 5.9 As regards the first upgrade of the Interconnector, ScottishPower's Transmission Business carried the whole of the financial risk until April 1993, when the works were well under

way. Since that time its GWD has paid annual charges intended to meet the annualised costs of 75 percent of the first upgrade in exchange for 75 percent of the available capacity. No information has been provided to the Director, or reported in ScottishPower's regulatory accounts, which would indicate that GWD has "underwritten" the cost of the first upgrade over the whole of its useful life. In ScottishPower's words, it simply "is paying for the costs of the Interconnector capacity which it uses" (ScottishPower letter of 18 October 1999).

- 5.10 The 16 April 1993 agreement makes no reference to the second upgrade of the Interconnector. ScottishPower has not notified the Director of any further agreement between its GWD and its Power System Divisions to underwrite its arrangements in respect of the second Interconnector upgrade. This indicates a misunderstanding, at least, in a letter of ScottishPower dated 14 October 1997 (referred to below) that said that the capacity of the second upgrade would be "allocated in full to the existing users who have funded the project." No information has been provided to the Director, or reported in ScottishPower's regulatory accounts, of any guarantee by GWD of the significant investment already reported by the Transmission Business in respect of the second upgrade or of the additional investment now proposed.
- 5.11 Condition 3B of Part VI of ScottishPower's composite licence specifies a procedure under which its Transmission Business has to prepare a statement of the basis upon which charges will be made for Interconnector upgrades, having regard (inter alia) to its likely future ability to recoup a proportion of such costs from third parties. No evidence has been provided that this procedure has been followed, in respect of either the first or the second Interconnector upgrade.
- 5.12 The Director considers that ScottishPower has implied to other users that access to the Interconnector upgrade capacity of the Interconnector had been taken by its GWD without justification, and appears to have acted in a manner which has advantaged its own GWD.
- 5.13 Further, ScottishPower's reference to underwriting could be interpreted to suggest that the only appropriate method of recompensing a party which finances the upgrade is to award that party unrestricted use of the upgrade capacity on a life of asset basis. The Director is of the view that in financing an upgrade of the Interconnector a procedure to ensure the possibility of third parties contributing to that investment through its use should be possible.

ScottishPower's treatment of third parties

5.14 The Director has been aware of ScottishPower's responses to applicants for access and to the terms on which access to the Interconnector has been offered for a number of years. On 14 October 1997, ScottishPower's Transmission Business responded to one such a request as follows:

"As indicated in our Access and Allocation Code, all of the export capacity of the existing Interconnector is fully utilised on a daily basis by Scottish exporters for bidding into the England and Wales Pool. A second capacity upgrade is under construction and, when complete, will be allocated in full to the existing users who have funded the project. Under the circumstances, I have to inform you that your capacity request cannot be accommodated from the capacity which exists or will exist following the second upgrade."

5.15 The response by ScottishPower implies that at the date of the letter third parties had no access to the Interconnector capacity of the upgrade in existence at that time. To gain access to upgrade capacity, third parties were obliged to submit a request to ScottishPower for the construction of further upgrade capacity by reference to condition 3B.3(b)(i) of Part VI of ScottishPower's composite licence.

5.16 The Director's determinations of 30 December 1998 stated, at paragraph 6.20, that he did not regard ScottishPower's reply of 14 October 1997 as satisfactory. In his view, the fact that the export capacity of the Interconnector might be fully utilised did not mean that a request for capacity could not be accommodated. In view of the capacity of the Interconnector; the limited extent of competition in Scotland; the duty of ScottishPower to make its transmission system including the Interconnector available to its competitors on terms which neither prevent nor restrict competition in supply or generation; and his own duty to promote competition, the Director believed that the possibility should exist for future applicants to have access to the Interconnector without having first to commission and wait for an upgrade.

5.17 Since that time, no third party has made a successful approach to ScottishPower for access to the Interconnector. However, the Director has received informal representations from interested third parties about the ScottishPower's Access and Allocation Code. The Director

is of the view that the present version of the Access and Allocation Code is acting as a potential barrier to entry.

- 5.18 In April 1999 ScottishPower submitted a revised Access and Allocation Code, following submission of its application for approval of reservation of upgrade capacity of the Interconnector. The Director considers that the proposed revision has not changed the content of the Access and Allocation Code to any significant degree. As such, the Director considers that the Access and Allocation Code continues to discourage third parties from seeking access to the Interconnector upgrade capacity.

Obligations and Duties

- 5.19 ScottishPower submits in its application that it and the Director are bound by the same competition duties. However, the statutory duty on ScottishPower is different from that imposed on the Director. The Director has a duty to exercise his functions in the manner best calculated to promote competition in the generation and supply of electricity. Scottish Power's duty is to facilitate competition in these areas by making its transmission system available to its competitors on terms which neither prevent nor restrict such competition.
- 5.20 The Director's statutory duties cannot and should not be construed by reference to ScottishPower's or any other operator's licence as ScottishPower suggest. The Director is not under the same obligations and duties as ScottishPower and cannot therefore be limited, as ScottishPower suggest, to apply the same criteria as ScottishPower would apply to third party applicants seeking access to the transmission system.
- 5.21 In discharging his obligations under Section 3 of the 1989 Act, the Director must have regard not only to competition as it is manifested in the market at the date of application but also have regard to the impact and effect of the decision sought on potential competition. Only by doing so will the Director be able to discharge his duty in relation to promotion of competition. In doing so it is legitimate and reasonable for the Director to have regard to the effect of the decision requested on competition in light of matters which are in the public domain, such as the Director's proposals for new trading arrangements which the Director has consulted upon and amendments proposed to legislation by way of the Utility Bill. In the performance of its statutory and licence duties, ScottishPower should have regard to similar considerations.

- 5.22 ScottishPower suggests that the Director is limited in discharging his duty under section 3(1)(c) of the 1989 Act in relation to the promotion of competition to consider Great Britain as a whole and is unable to discharge this duty in relation to a part of Great Britain such as England, Scotland or Wales. The Director rejects this suggestion. Section 3 of the 1989 Act does not limit the territorial extent of the Director's duties by reference to Great Britain or any part thereof nor can one reasonably imply such a restriction into the Director's duties. There is no such territorial limitation imposed on the Director's duty in relation to promoting competition.
- 5.23 It is the Director's view that he is required to be concerned with impacts on competition in a particular market within Great Britain and/or within the Great Britain market as a whole. Relevant legislation includes Section 3 of the 1989 Act. This applies to the Director's duty in relation to the promotion of competition in the generation and supply of electricity; he is not limited to treating Great Britain generation as a single market. He may act to promote competition or deal with competition concerns arising in respect of any part, including England, Scotland or Wales.
- 5.24 ScottishPower also suggests that the Director is unable to apply different treatment to different applicants i.e. ScottishPower and third party applicants. The Director rejects this suggestion. Under the 1989 Act, the Director's duties are wider than the issue of facilitating access to transmission systems to competitors on terms which neither prevent nor restrict competition. This duty applies to ScottishPower. The Director has a wider duty to exercise his functions in the manner best calculated to promote competition in the generation and supply of electricity. This duty cannot be fettered by tying the discharge of the Director's duty to that of licence holders such as ScottishPower. The Director is entitled to distinguish between market participants should it be necessary to fulfil his duty to promote competition within Great Britain or any part thereof.
- 5.25 The Director in exercising his duty to promote competition must also comply with the principle of non-discrimination. The principle of non-discrimination does not require that situations which differ objectively be treated comparably. This means that the Director is entitled to differentiate between, on the one hand, ScottishPower (and other comparable companies) and, on the other hand, third parties regarding access to the Interconnector. There are relevant objective differences between ScottishPower (and other comparable

companies) and third parties, including ScottishPower's structure, its market power and its licence obligations.

Conclusion

5.26 In the light of the above, the Director's preliminary view is that:

- ◆ ScottishPower's claims that ScottishPower's GWD has underwritten the investment made by the Transmission Business for the upgrade capacity of the Interconnector is unsubstantiated;
- ◆ in financing an upgrade of the Interconnector a procedure to allow for the possibility of third parties contributing to that investment through its use should be possible;
- ◆ the present and proposed criteria of ScottishPower's Transmission Business for allocation of capacity in the Interconnector may discourage third parties from seeking access to the upgrade;
- ◆ ScottishPower appears to have acted in a manner which has advantaged its own GWD and disadvantaged third parties, and in its application appears to be seeking a determination which would support its previous actions and continue their effect;
- ◆ in light of the Directive and the terms of the current version of the Access and Allocation Code, it is questionable whether ScottishPower is presently able to discharge its statutory duty under section 9(3) of the 1989 Act to make its transmission system available to its competitors on terms which neither restrict nor prevent competition; and
- ◆ the Director does not believe that in relation to the current Interconnector arrangements for Access and Allocation that ScottishPower would grant an application from an arm's length third party on the terms ScottishPower has submitted to the Director.

5.27 The Director is not satisfied that to grant the application requested by ScottishPower would be compatible with the discharge of his statutory duty under section 3(1)(C) of the 1989 Act to exercise his functions in a manner best calculated to promote competition in the generation and supply of electricity. The Director is of the view that the promotion of competition would not be served by reserving to ScottishPower 75 percent of the upgrade capacity in the Interconnector until 2034. This would have the effect of restricting access to

a significant part of the Interconnector and allow ScottishPower to avoid its duty under section 9(3) of the 1989 Act, to make its transmission system available to its competitors on terms which neither restrict nor prevent competition. The Director is presently of the view that ScottishPower's application is incompatible with the performance of its duty under the 1989 Act.

6. Supplementary Arguments

- 6.1 ScottishPower's application includes further issues which are commented on in this Chapter. For the avoidance of doubt it should be noted that where Ofgem has not commented on an argument raised or assertion made by ScottishPower this does not mean that the Director acquiesces or otherwise agrees with ScottishPower's position.
- 6.2 ScottishPower supports its application on the basis of a number of supplementary arguments which are summarised in paragraph 3.3 of Chapter 3. Ofgem is minded to reject the supplementary arguments, on the following basis:
- ◆ The Prospectus (on page 69) quoted the Director's view that the upgrade "should enhance the potential for competition in generation and supply between Scotland and England and Wales". Ofgem's view is that the strengthening of the interconnecting links relates not simply to "exports" from Scotland to England and Wales but the facilitation of two-way "trading". Trading involves the opportunity for all generators to have equivalent rights to obtain access to upgrades that the transmission licensee may propose.
 - ◆ The investments in Cockenzie and Longannet power stations were undertaken by ScottishPower in the full knowledge that the company did not have, and had not requested approval of, a reservation of Interconnector capacity. If ScottishPower was concerned to avoid these risks, it could have sought approval of such a reservation of capacity in advance of committing the expenditure.
 - ◆ The Director cannot be constrained by business plans and information that ScottishPower may have relayed to investors, analysts, the Regulator (being the Director and his staff) and others. ScottishPower and its competitors will need to adapt its businesses and business prospects following changes to the market. In respect of Interconnector access, the implementation of the Directive, and the Competition Act 1998, are instances of change that reinforce the requirement that all market participants be enabled to have an opportunity to have access to the Interconnector.

7. Conclusion

- 7.1 The Director considers that the present criteria for access to the Interconnector and that proposed by ScottishPower fails to satisfy the requirements of the Directive and fail to satisfy ScottishPower's statutory duty under section 9(3) of the Electricity Act 1989.
- 7.2 ScottishPower submits and the Director agrees that both ScottishPower and the Director are bound to comply with the Directive. The Directive requires the establishment of a transmission system operator that is managerially separate from all other electricity activities. This is not presently the case as no transmission system operator exists consistent with the Directive, nor do the terms of access meet the objectives of the Directive. Ofgem has recently set out licence modifications as one step towards achieving compliance with the Directive. Other measures will be required. A grant of the reservation requested by ScottishPower by the Director could be seen as acquiescence to this non-compliance and could put the Director in breach of his European Community law obligations and duties for the reasons set out in this proposed determination.
- 7.3 The Director has a duty under the 1989 Act to act (amongst other things) in a manner best calculated to promote competition in relation to the generation and supply of electricity. One of ScottishPower's obligations under the Act is to facilitate competition in these areas by making its transmission system available to its competitors on terms which neither prevent nor restrict competition. The Director considers that granting of ScottishPower's application would be inconsistent with both of these.
- 7.4 In light of the matters set out in this document, the Director is presently minded not to approve the reservation to ScottishPower's Wholesaling Business of 75 percent upgrade capacity of the Interconnector as requested in its application of 22 April 1999.

Annex A List of Respondents

There were 21 respondents to the September consultation paper, listed as follows:

Acharn Hydro Ltd

BOC Gases

British Energy

British Gas Trading

Caledonian Paper Ltd

Chemical Industries Association

Enron Europe Limited

Energy Trading BV

London Electricity

Major Energy Users Council

National Grid Company

National Power

Northern Ireland Electricity plc

PowerGen

RJB Mining (UK) Ltd

ScottishPower

Scottish and Southern Energy

Scottish Renewables Forum

TXU Europe Power

Yorkshire Electricity plc

Plus one confidential response.

Annex B Extracts from EC Directive 96/92/EC

Article 7

1. Member States shall designate or shall require undertakings which own transmission systems to designate, for a period of time to be determined by Member States having regard to considerations of efficiency and economic balance, a system operator to be responsible for operating, ensuring the maintenance of, and, if necessary, developing the transmission system in a given area and its interconnectors with other systems, in order to guarantee security of supply.
2. Member States shall ensure that technical rules establishing the minimum technical design and operational requirements for the connection to the system of generating installations, distribution systems, directly connected consumers equipment, interconnector circuits and direct lines are developed and published. These requirements shall ensure the interoperability of systems and shall be objective and non-discriminatory. They shall be notified to the Commission in accordance with Article 8 of Council Directive 83/189/EEC of 28 March 1983 laying down a procedure for the provision of information in the field of technical standards and regulations.⁴
3. The system operator shall be responsible for managing energy flows on the system, taking into account exchanges with other interconnected systems. To that end, the system operator shall be responsible for ensuring a secure, reliable and efficient electricity system and, in that context, for ensuring the availability of all necessary ancillary services.
4. The system operator shall provide to the operator of any other system with which its system is interconnected sufficient information to ensure the secure and efficient operation, co-ordinated development and interoperability of the interconnected system.
5. The system operator shall not discriminate between system users or classes of system users, particularly in favour of its subsidiaries or shareholders.

⁴ OJ No L 109, 26.4. 1983, p.8 Directive as last amended by the 1994 Act of Accession.

6. Unless the transmission system is already independent from generation and distribution activities, the system operator shall be independent at least in management terms from other activities not relating to the transmission system.

Article 8

1. The transmission system operator shall be responsible for dispatching the generating installations in its area and for determining the use of interconnectors with other systems.
2. Without prejudice to the supply of electricity on the basis of contractual obligations, including those which derive from the tendering specifications, the dispatching of generating installations and the use of interconnectors shall be determined on the basis of criteria which may be approved by the Member State and which must be objective, published and applied in a non-discriminatory manner which ensures the proper functioning of the internal market in electricity. They shall take into account the economic precedence of electricity from available generating installations of interconnector transfers and the technical constraints on the system.
3. A Member State may require the system operator, when dispatching generating installations, to give priority to generating installations using renewable energy sources or waste or producing combined heat and power.
4. A Member State may, for reasons of security of supply, direct that priority be given to the dispatch of generating installations using indigenous primary energy fuel sources, to an extent not exceeding in any calendar year 15 percent of the overall primary energy necessary to produce the electricity consumed in the Member State concerned.

Article 16

For the organisation of access to the system, Member States may choose between the procedures referred to in Article 17 and/or in Article 18. Both sets of procedure shall operate in accordance with objective, transparent and non-discriminatory criteria.

Article 17

1. In the case of negotiated access to the system, Member States shall take the necessary measures for electricity producers and, where Member States authorise their existence, supply undertakings and eligible customers either inside or outside the territory covered by the system to be able to negotiate access to the system so as to conclude supply contracts with each other on the basis of voluntary commercial agreements.
2. Where an eligible customer is connected to the distribution system, access to the system must be the subject of negotiation with the relevant distribution system operator and, if necessary, with the transmission system operator concerned.
3. To promote transparency and facilitate negotiations for access to the system, system operators must publish, in the first year following implementation of this Directive, an indicative range of prices for use of the transmission and distribution systems. As far as possible, the indicative prices published for subsequent years should be based on the average price agreed in negotiations in the previous 12-month period.
4. Member States may also opt for a regulated system of access procedure, giving eligible customers a right of access, on the basis of published tariffs for the use of transmission and distribution systems, that is at least equivalent, in terms of access to the system, to the other procedures for access referred to in this Chapter.
5. The operator of the transmission or distribution system concerned may refuse access where he lacks the necessary capacity. Duly substantiated reasons must be given for such refusal, in particular having regard to Article 3.

Annex C Conditions 3 and 3B of Part VI of ScottishPower's Composite Licence

Condition 3. basis of charges for use of the Scottish interconnection

1. Unless (and except for so long as) the Director approves otherwise, charges for use of the Scottish interconnection shall be set at a level which will enable the Licensee to recover no more than a reasonable rate of return on the relevant proportion of the capital represented by the Scottish interconnection.
2. The Licensee shall as soon as practicable after the Transmission Licence has come into force, and, in any event, not later than such date as the Director shall specify, prepare a statement approved by the Director setting out the basis upon which charges for use of the Scottish interconnection will be made, such statement to be in such form and to contain such detail as shall be necessary to enable any person to make a reasonable estimate of the charges to which it would become liable for use of the Scottish interconnection, and (without prejudice to the foregoing) including the information required to be included therein pursuant to paragraph 3.
3. Except to the extent that the Director shall otherwise specify, the statement referred to in paragraph 2 shall include:
 - (a) a schedule of charges for transport of electricity under use of the Scottish interconnection;
 - (b) the charge for maintaining voltage and frequency within statutory limits;
 - (c) a schedule of the adjustment factors to be made in respect of transmission losses, in the form of additional supplies required to cover those transmission losses;
 - (d) the methods by which and the principles on which charges (if any) will be made for availability of capacity on the Scottish interconnection; and

- (e) such other matters as shall be specified in directions issued by the Director from time to time for the purposes of this Condition.
4. In addition to, and without prejudice to, the Licensee's obligations under paragraph 2, the Licensee shall, upon being directed to do so in directions issued by the Director from time to time for the purposes of this Condition and within such period as shall be specified in the directions, prepare a statement approved by the Director providing that charges for use of the Scottish interconnection will be made on such basis as shall be specified in the directions and such statement shall be in such form and contain such detail as shall be necessary to enable any person to make a reasonable estimate of the charges to which it would become liable for use of the Scottish interconnection and (without prejudice to the foregoing) including such information as shall be specified in the directions. Each statement prepared in accordance with this paragraph shall, with effect from the date on which it is approved by the Director or such later date as the Director shall specify, replace the corresponding statement prepared by the Licensee in accordance with paragraph 2 or, as the case may be, this paragraph (as from time to time revised in accordance with paragraph 5) which is in force at such date and the Licensee shall, with effect from such date, make charges for use of the Scottish interconnection in accordance with the statement (as from time to time revised in accordance with paragraph 5) which has replaced such corresponding statement.
5. The Licensee may periodically revise the statement prepared in accordance with paragraph 2 or, in the event that the Licensee shall have prepared a statement in accordance with paragraph 4, that statement or the latest of such statements and shall, at least once in every year the Transmission Licence is in force, revise such statement in order that the information set out therein shall continue to be accurate in all material respects. Each such revision shall require to be approved by the Director and shall not become effective until approved by the Director.
6. The Licensee shall as soon as practicable after the Transmission Licence has come into force and, in any event, not later than such date as the Director shall specify prepare a statement approved by the Director showing:

- (a) the amount of the capacity of the Scottish interconnection which the Licensee anticipates will be available for the transfer of electricity from Scotland to England and England to Scotland during each remaining week of the year ending on 31 March 1991 as notified by the Licensee to SHE pursuant to the Interconnector Agreement;
 - (b) the amount of that capacity in relation to which SHE has a right to require the Licensee to receive and deliver electricity as referred to in sub-paragraph (b) of paragraph 13;
 - (c) the Licensee's forecast of the amount of the remainder of the capacity of the Scottish interconnection which will be used for the transfer of electricity from Scotland to England and from England to Scotland during each week referred to in sub-paragraph (a) above; and
 - (d) such other matters (if any) as the Director shall specify prior to his approval of the statement.
7. The Licensee shall, as soon as practicable (and, in any event, within such period as the Director shall specify) after giving a notification such as is referred to in sub-paragraph (a) of paragraph 6 to SHE in respect of the year ending on 31 March 1992 and each subsequent year, prepare a statement approved by the Director showing the matters referred to in sub-paragraphs (a) to (d) of paragraph 6 in respect of that year.
8. The Licensee shall send a copy of the statement prepared in accordance with paragraph 2 and any statement prepared in accordance with paragraph 4, and of each revision of such statements in accordance with paragraph 5, and of each statement prepared in accordance with paragraphs 6 and 7 and with paragraphs 3(a) and 8 of Condition 3B, to the Director.
9. The Licensee shall give or send a copy of the statement prepared in accordance with paragraph 2, any statement prepared in accordance with paragraph 4 or (as the case may be) of the latest revision of the relevant statement in accordance with paragraph 5 approved by the Director pursuant to such paragraph and of each statement prepared in accordance with paragraphs 6 and 7 to any person who requests a copy of such statement.

10. The Licensee shall also give or send a copy of each statement prepared in accordance with paragraphs 3(a) and 8 of Condition 3B to any person who requests a copy of such statement.
11. The Licensee may make a charge for any statement given or sent pursuant to paragraph 9 of an amount reflecting the Licensee's reasonable costs of providing such a statement which shall not exceed the maximum amount specified in directions issued by the Director for the purposes of this Condition.
12. The Licensee may within 10 days after receipt of the relevant request provide an estimate of its reasonable costs in the preparation of any statement referred to in paragraph 10, and its obligation to provide such statement shall be conditional on the person requesting such statement agreeing to pay the amount estimated or such other amount as the Director may, upon the application of the Licensee or the person requesting such statement, direct.
13. For the purposes of this Condition and Conditions 3A to 3C and 4:

“Interconnector Agreement”

means at any time the agreement relating to the matter referred to in sub-paragraph (a)(iv) of paragraph 5 of Condition 7 of Part II in force at that time which has been entered into and submitted to the Director pursuant to that Condition as the same may be amended from time to time with the approval of the Director given pursuant to such Condition.

“use of the Scottish interconnection”

shall exclude:

the rights conferred upon SHE under the Interconnector Agreement to require the Licensee:

- (a) to receive electricity from SHE at the Combined Delivery Point (and from certain generating stations referred to in the Interconnector Agreement) and deliver such electricity (less losses as referred to in the Interconnector Agreement) to the Transmission Company at the Southern Delivery Point; and/or
- (b) to receive electricity from the Transmission Company at the Southern Delivery Point and deliver such electricity (less losses as referred to in the Interconnector Agreement) to SHE at the Combined Delivery Point; and

the rights conferred upon British Nuclear Fuels plc under the existing agreement referred to in sub-paragraph (a)(iv) of paragraph 5 of Condition 7 of Part II

“relevant proportion of the capital represented by the Scottish interconnection”

means at any time, a proportion of such capital equal to the percentage of the Reserved Share (as defined in the Interconnector Agreement) of the Licensee at that time.

“Combined Delivery Point”

means the points at the boundary between the Licensee's authorised transmission area and SHE's authorised transmission area defined as such in the Interconnector Agreement.

"Southern Delivery Point"	means the points at the boundary between the Licensee's authorised transmission area and the Transmission Company's authorised transmission area defined as such in the Interconnector Agreement.
"Upgrade"	means any alteration, modification or addition to the Interconnected Scottish Power System (as defined in the Interconnector Agreement) which is primarily designed to effect a permanent increase in one or more Particular Interconnection Capacities.
"interconnection"	<p>means:</p> <p>the 275 kV transmission circuits between and including the associated switchgear at Harker sub-station in Cumbria and the associated switchgear at Strathaven sub-station in Lanarkshire;</p> <p>the 275 kV transmission circuit between and including the associated switchgear at Cockenzie in East Lothian and the associated switchgear at Stella in Tyne and Wear; and</p> <p>the 400 kV transmission circuit between and including the associated switchgear at Torness in East Lothian and the associated</p>

switchgear at Stella in Tyne and Wear

all as existing at the date on which the Transmission Licence comes into force and as from time to time maintained, repaired or renewed, together with any alteration, modification or addition (other than maintenance, repair or renewal) which is primarily designed to effect a permanent increase in one or more Particular Interconnection Capacities as they exist immediately prior to such alteration, modification or addition and as from time to time maintained, repaired or renewed; and

the 132 kV transmission circuit between and including (and directly connecting) the associated switchgear at Chapelcross and the associated switchgear at Harker sub-station in Cumbria; and

the 132 kV transmission circuit between and including (and connecting, via Junction V) the associated switchgear at Chapelcross and the associated switchgear at Harker sub-station in Cumbria

all as existing at the date on which the Transmission Licence comes into force and as from time to time maintained, repaired

or renewed.

“Scottish interconnection” means such part of the interconnection as is situated in Scotland.

“Particular Interconnection Capacity” means the capacity of the interconnection for transferring electricity from Scotland to England or vice versa in respect of any particular system conditions.

“co-operator” means any person other than the Licensee who owns assets which are used in conjunction with the interconnection or who is able to exercise jointly with the Licensee control over the use made of the interconnection.

Condition 3B. Requirement to offer terms

1. On application made by any person, the Licensee shall (except in a case where paragraph 2 applies and subject to paragraph 7) offer to enter into an agreement for use of the Scottish interconnection to transport across the Scottish interconnection in such quantities and for such periods as may be specified in the application, electricity to be provided by or on behalf of such person:
 - (a) specifying the charges for use of the Scottish interconnection to be paid by the person seeking use of the Scottish interconnection, such charges to be referable to the statement referred to at paragraph 2 or (as the case may be) paragraph 4 of Condition 3 or any revision thereof; and
 - (b) containing such further terms as are or may be appropriate for the purposes of the agreement.

2. This paragraph applies in any case where, on the application of the Licensee or any person entitled or claiming to be entitled to an offer pursuant to an application under paragraph 1, the Director shall determine that (having regard to the part of the capacity of the Scottish interconnection already contracted to persons other than the Licensee and affiliates and related undertakings of the Licensee and the part thereof approved by the Director as being reserved to the Licensee and affiliates and related undertakings of the Licensee for the purpose of the Supply Business, Second Tier Supply Business and Wholesaling Business) the capacity of the Scottish interconnection is insufficient to accommodate the requirements of the person who has made application for an offer pursuant to paragraph 1.

3. In a case where paragraph 2 applies:
 - (a) the Licensee shall (subject to paragraph 12 of Condition 3), if requested by the person who has made application for an offer pursuant to paragraph 1 and within such period as the Director shall specify in his determination under paragraph 2, prepare a statement approved by the Director setting out the basis upon which charges will be made for the costs which the Licensee would incur if an Upgrade were to be carried out in accordance with the Interconnector Agreement to accommodate the requirements of the person who has made the application for an offer pursuant to paragraph 1, such statement to be in such form and to contain such detail as shall be necessary to enable such person to make a reasonable estimate of the charges to which he would become liable in respect of the Upgrade; and

 - (b) following the preparation of a statement under sub-paragraph (a) above, the Licensee shall, on the application of the person who has made the application for an offer pursuant to paragraph 1, offer to enter into:
 - (i) an agreement pursuant to which the Licensee undertakes to exercise its rights under the Interconnector Agreement to require the carrying out of an Upgrade; and

- (ii) an agreement such as is referred to in paragraph 1, but so that the Licensee shall not be bound to make use of the Scottish interconnection available pursuant to such agreement until the time of completion of the Upgrade.

- 4. Charges in respect of Upgrades carried out pursuant to an agreement such as is referred to in sub-paragraph (b)(i) of paragraph 3 will be set at a level which will enable the Licensee to recover:
 - (a) the appropriate proportion of the costs directly incurred by the Licensee in connection with Upgrades; and
 - (b) a reasonable rate of return on the capital represented by such costs.

- 5. For the purpose of determining an appropriate proportion of the costs directly incurred in connection with an Upgrade, the Licensee shall have regard to:
 - (a) the benefit (if any) to be obtained or likely in the future to be obtained by the Licensee or any other person from the increase in the capacity of the Scottish interconnection resulting from the Upgrade; and
 - (b) the ability or likely future ability of the Licensee to recoup a proportion of such costs from third parties.

- 6. The Licensee shall offer terms for agreements in accordance with paragraph 1 and paragraph 3(b) as soon as practicable and (save where the Director consents to a longer period) in any event not more than the period specified in paragraph 9 after receipt by the Licensee of an application containing all such information as the Licensee may reasonably require for the purpose of formulating the terms of the offer.

- 7. The Licensee shall not be obliged pursuant to this Condition to offer to enter or to enter into any agreement:

- (a) if to do so would involve the Licensee:
 - (i) in breach of its duties under Section 9 of the Act; or
 - (ii) in breach of the Electricity Supply Regulations 1988 or of any regulations made under Section 29 of the Act or of any other enactment relating to safety or standards applicable to the interconnection; or
 - (iii) in breach of the Conditions to which the Transmission Licence is subject; or
 - (b) if the person making the application does not undertake to be bound by the terms of any code of general application or agreement between the Licensee and any co-operator of the interconnection governing the operation of and maintenance of the interconnection approved for the time being by the Director; or
 - (c) if (in the case of an application for an agreement for use of the Scottish interconnection to transport electricity from the Southern Delivery Point) the electricity to be so transported is to be transported from the northern end of the Scottish interconnection to the Combined Delivery Point under an agreement for use of the Licensee's Transmission System or Distribution System; or
 - (d) if (in the case of an application for an agreement for use of the Scottish interconnection to transport electricity to the Southern Delivery Point) the electricity to be so transported is to be transported from the Combined Delivery Point to the northern end of the Scottish interconnection under an agreement for use of the Licensee's Transmission System or Distribution System.
8. If so requested by any person, the Licensee shall (subject to paragraph 12 of Condition 3), as soon as practicable and in any event not later than the expiry of such period as the Director, on the application of the person making the request, shall determine for this purpose, give or send to such person a statement approved by the Director setting out the basis upon which charges will be made for the costs which the Licensee would incur if an Upgrade were to be carried out in accordance with the Interconnector Agreement to accommodate the

requirements of such person as specified in the request, such statement to be in such form and to contain such detail as shall be necessary to enable such person to make a reasonable estimate of the charges to which it would become liable in respect of the Upgrade.

9. For the purpose of paragraph 1, the period specified shall be 28 days. For the purpose of paragraph 3(b), the period specified shall be 3 months.

10. The Licensee shall within 28 days following receipt of a request from any person, give or send to such person such information in the possession of the Licensee as may be reasonably required by such person for the purpose of completing paragraph 8 of Part 1 and paragraphs 2(v) and (vi) of Part 2 of Schedule 2 to the Electricity (Application for Licences and Extensions of Licences) Regulations 1990 or such provisions to like effect contained in any further regulations then in force made pursuant to Sections 6(3), 60 and 64(1) of the Act.