

March 2001

**Interim Administered Access
Arrangements on Scotland-England
Interconnector**

Final proposals

Executive summary

This paper sets out interim interconnector access criteria for the Scotland-England interconnector ("the interconnector").

The proposed criteria would be applied by the transmission businesses of Scottish Power plc ("ScottishPower") and Scottish & Southern Energy plc ("Scottish & Southern Energy"), when responding to applications by third parties, for use of interconnector capacity within their respective transmission areas.

The proposed criteria consist of a set of rules that will enable third parties and the Generation and Wholesale (the "Generation") businesses of ScottishPower and Scottish & Southern Energy to have interconnector access, pending the introduction of enduring arrangements.

Ofgem considers that the proposed criteria are open, transparent, equitable and proportionate. It is important to note that this is only phase I in a project to move to competitive, non-discriminatory interconnector access arrangements.

Ofgem notes that these criteria do not address some significant issues surrounding interconnector access such as:

- the allocation of capacity to third parties by ScottishPower and Scottish & Southern Energy on an all-Scotland basis;
- the different interconnector use of system capacity charges which apply to the pre and post-Vesting interconnector; and
- the application of different criteria to third parties and the hosts' Generation businesses.

As part of the process to address these issues, Ofgem has begun to work on phase II of the project and shall shortly consult on introducing dynamic access arrangements. The dynamic arrangements could address these three issues and will provide more economically efficient arrangements. Phase III of the project will be to move to GB transmission access arrangements. This is in line with the vision of moving to GB trading and transmission access arrangements, set out in the document entitled

'Interim proposals for the reform of Scottish trading arrangements: British Electricity Trading and Transmission Arrangements ("BETTA")'¹ ("the August 2000 document"). Ofgem intends to consult on phase III later in the year.

As such, this paper is only concerned with measures to improve the present administered access arrangements (phase I), prior to a move to more enduring arrangements.

Rationale

The Authority has a statutory responsibility to exercise its duties in a manner best calculated to protect customers and, consistent with that, a duty to promote competition. In the absence of a market mechanism to allocate interconnector capacity, Ofgem proposes that ScottishPower and Scottish & Southern Energy adopt the criteria set out in this paper on acceptance of these proposals. Implementing the criteria is a first step to introducing more competitive interconnector access and towards compliance with the access criteria set out in the EU Directive 96/92/EC ("the Directive")².

Comments

ScottishPower and Scottish & Southern Energy are requested by Ofgem to respond to these proposals by 20 March 2001. If both accept them, then the revised access criteria will apply on the agreed basis from that date forward. If the criteria are not acceptable to either party, then Ofgem will seek to facilitate change by other routes. Ofgem shall inform market participants of the outcome by putting a notice on its website.

Comments from any interested parties on any of the issues raised in this paper and its appendix are welcome and should be sent in writing or e-mailed not later than 20 March 2001 to:

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¹ Available from Ofgem website www.ofgem.gov.uk and library

² EU Directive 96/92/EC concerning common rules for the internal market in electricity OJ L 27/20

Respondents are free to mark their responses as confidential although we would prefer, as far as possible, to be able to place responses to this document in the Ofgem library. Unless clearly marked 'confidential', responses will be published by placing them in the Ofgem library.

If you wish to discuss any aspect of this document, please contact Joyce Craig, Joyce.Craig@ofgem.gov.uk (telephone 0141 331 2737) who will be pleased to help.

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Interim Administered Access Criteria on the Scotland-England Interconnector

Introduction

- 1.1 In August 2000, Ofgem published the August 2000 document which:
 - summarised the main factors inhibiting the development of competition in Scotland;
 - proposed that enduring GB trading and transmission access and charging arrangements are developed, as part of BETTA; and
 - proposed interim arrangements to promote competition, pending the introduction of enduring arrangements.
- 1.2 Paper 4 of the August 2000 document entitled 'Interconnector Access Arrangements' ("the August 2000 paper") set out initial proposals for the introduction of new arrangements to allocate access on the interconnector. These were scheduled for implementation from April 2001.
- 1.3 This paper sets out final proposals for interim administered access criteria (phase I), for implementation by ScottishPower and Scottish & Southern Energy, on acceptance of these proposals.
- 1.4 The appendix to this paper :
 - summarises the initial interim proposals;
 - summarises the responses to the August 2000 paper;
 - provides an update of relevant events since the August 2000 paper was published; and
 - discusses the responses to the August 2000 paper.

Final proposals on interim administered access arrangements for the Scotland-England interconnector

- 1.5 Following careful consideration of the responses to the August 2000 paper, points raised by parties in subsequent meetings and letters, and having regard to other relevant events, Ofgem sets out below its final proposals on interim administered interconnector access arrangements.

North-south pre-Vesting and post-Vesting interconnector capacity allocation:

- 1.6 Any party other than ScottishPower, Scottish & Southern Energy and British Energy will be allocated interconnector capacity in tranches of 1 MW or more on request. Ofgem proposes that capacity allocation will be made up to a maximum of 50 per cent of the applicant's registered generation capacity, available for export onto the host transmission system.
- 1.7 Following the allocation of such capacity to a third party, Ofgem proposes that it would reserve to the host's Generation business an equivalent level of capacity, thereby enabling the host's Generation business to secure equivalent access rights to those of third parties.
- 1.8 Interconnector capacity not allocated under this decision rule, or by a determination by Ofgem, would be available for use by the host's Generation business pending such allocations (either by the application of these criteria or by a determination). For the avoidance of doubt, this is a default position and does not prevent third parties seeking access to such capacity by either the decision rule or by determination.
- 1.9 In 1998, the Director determined that BNFL has access rights to 196 MW of ScottishPower's pre-Vesting interconnector capacity until 31 March 2002³. This allocation of capacity is firm, and while ScottishPower's obligation to BNFL remains (that is until 31 March 2002), this capacity entitlement must be met before any capacity is deemed available for third parties.

³ Determination by Director General of Electricity Supply of application 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 Ofgem December 1998.

South-north interconnector capacity allocation:

- 1.10 Under normal operating conditions, there are few capacity constraints for south-north flows across the interconnector. The Transmission licensees can usually meet in full any requests for south-north interconnector capacity up to around 1350 MW.
- 1.11 In light of comments to Ofgem from parties seeking to import into Scotland about the lack of transparency of south-north arrangements, Ofgem asks the host Transmission licensees to review, and enhance where necessary the Access and Allocation Codes. These should provide details of, for example, the application procedure for importing into Scotland, and the contractual, commercial and technical rules for south-north trades. The Codes should be supported by making available all necessary forms and contracts, to include the standard use of interconnector agreements, as annexes to the Codes. These should be made available by 30 April 2001.

Implementation

- 1.12 The August 2000 paper assumed revised administered access arrangements would be introduced from April 2001. The existing administered access arrangements are set out in the Access and Allocation codes. These Codes are not required by a licence condition. Rather, the Use of Interconnector Agreement (Scotland) 1991 makes provision for ScottishPower and Scottish & Southern Energy to transfer electricity, or cause electricity to be transferred, across the NGC interconnector circuits. In exercising these rights, Clause 14 of that agreement requires ScottishPower and Scottish & Southern Energy to undertake the relevant statutory and licence duties of NGC, to include the duty to facilitate competition.
- 1.13 Under Clause 14, ScottishPower and Scottish & Southern Energy are also required to each have in force an Access and Allocation Code which has been consulted on and which covers all material commercial aspects relating to use of NGC interconnector circuits.
- 1.14 The Clause provides that the Authority has the power, either in response to any representation by a party to the Agreement or a materially affected person, to

vary or substitute any provisions of the Agreement. This Clause ensures that, at all times, NGC, Scottish & Southern Energy and ScottishPower comply with Clause 14 and the statutory and licence obligations of NGC, ScottishPower and Scottish & Southern Energy.

- 1.15 The Codes may be modified at any time by the licensees, subject to consultation and to Ofgem's approval.
- 1.16 Ofgem has declined to approve amendments to these Codes since 1995, save for consequential amendments to facilitate the introduction of New Electricity Trading Arrangements ('NETA').
- 1.17 To provide the host Transmission licensees (and other parties) with greater certainty to enable them to respond to requests from third parties for interconnector access, Ofgem requests them to implement these phase I criteria on acceptance of these proposals. The implementation method is a matter for the licensees, provided it is done in a timely manner and complies with all relevant obligations.
- 1.18 In addition, secondary trading should be facilitated under the existing Trading Code, supplemented by a 'use it or lose it' facility. Ofgem requests that the hosts Transmission licensees bring forward details for a possible 'use it or lose it' facility within revised draft Access & Allocation Codes.

Duration

- 1.19 Shortly, Ofgem will issue a consultation paper on introducing market-based arrangements on the interconnector. In order to provide certainty to market participants, Ofgem proposes that the phase I administered access criteria will apply until the earlier of the introduction of dynamic arrangements (phase II), or 1 April 2002.
- 1.20 Ofgem remains committed to delivering BETTA. However, Ofgem has concerns about access arrangements in the intervening period. For example, both host transmission licensees received a request for access from a third party. Neither licensee felt able to respond to the request for access beyond April 2001 because of this consultation process. As such, Ofgem is of the opinion that it is reasonable and appropriate to introduce interim arrangements. It is important to

stress that these proposals are interim (phase I) only pending the move to more enduring arrangements.

APPENDIX 1

1. This appendix has four sections namely:
 - Section 1 - which summarises the August 2000 consultation paper;
 - Section 2 - which summarises responses to the August 2000 consultation paper;
 - Section 3 - which sets out some relevant events which have occurred since publication of the August 2000 consultation paper; and
 - Section 4 - which discusses the responses to the August 2000 paper.

Section 1: August 2000 consultation paper

- 1.1 The August 2000 paper explained that the existing access criteria governing access to the interconnector are set out in the Access and Allocation Codes ("Codes") of the Scottish Transmission licensees. These Codes have been the subject of review by Ofgem. This review followed Ofgem's concerns, as expressed in the BNFL determination and a proposed determination⁴, regarding compliance of the terms of the Codes with the Directive and the perceived effect that the existing Codes have had in limiting access to the interconnector by third parties.
- 1.2 In the August 2000 paper, Ofgem explained that it considered that it was necessary for access arrangements to be administered, pending the development and introduction of market arrangements for BETTA. The August 2000 paper assumed a BETTA implementation date of no earlier than April 2002. As such, the interim arrangements were expected to have at least a one year duration.
- 1.3 The proposed interim access arrangements focussed on enabling third parties to use some of the 850 MW of interconnector capacity in place at Vesting. The costs associated with providing and operating this 850 MW of capacity are recovered in general transmission use of system charges, and the interconnector capacity charge for this portion is zero. This capacity is described as "firm" capacity, in that, under the Pooling and Settlement Agreement, generators

⁴ Proposed determination by Director General of Electricity Supply of application by ScottishPower plc for approval of reservation of upgrade capacity on the Scottish interconnection: Ofgem March 2000

receive constraint payments in the event that 850 MW cannot be transferred by NGC on the England & Wales transmission system.

- 1.4 Interconnector capacity in excess of 850 MW is “non-firm”, in that, for such capacity, generators do not receive constraint payments in the event that the capacity cannot be delivered by NGC on the transmission system in England & Wales. The cost of providing and operating this post-Vesting capacity is recovered entirely from interconnector users, through an interconnector capacity charge.
- 1.5 The August 2000 paper proposed interim access arrangements for the interconnector which sought to:
 - promote competition into and out of Scotland;
 - be simple to implement, apply and administer;
 - not unduly alter the present balance of capacity allocated to the Generation businesses of ScottishPower and Scottish & Southern Energy, in the absence of third parties;
 - be in keeping with the requirements of the Directive; and
 - be consistent with the longer-term direction of policy proposed for transmission access and pricing within BETTA.
- 1.6 The August 2000 paper recognised that ScottishPower, Scottish & Southern Energy and British Energy are the three dominant generators in Scotland. They have ownership of over 98 per cent of existing generation capacity in Scotland. The paper stated that, in order to promote competition, parties other than these should be allocated some “firm” interconnector capacity on request.
- 1.7 The initial proposals in the August 2000 paper related to the allocation of “firm” pre-Vesting and “non-firm” post-Vesting interconnector capacity are summarised below.

North-south pre-Vesting interconnector capacity allocation

- 1.8 Any party, other than ScottishPower, Scottish & Southern Energy and British Energy, would be able to request an allocation of the "firm" interconnector capacity (up to 850 MW) from its host Transmission licensee, up to a level of 50 per cent of the applicant's registered generation capacity, available for export onto the host's transmission system. This would apply provided that the host Transmission licensee, acting in accordance with these rules, or under a determination by the Authority, had not previously allocated the interconnector capacity. When allocating interconnector capacity to such a third party, the Transmission licensee would be entitled to a reservation from the Authority of an equivalent level of capacity to its own Generation business, provided that "firm" capacity (up to 850 MW) was available and had not previously been allocated. This would enable the hosts' Generation businesses to secure equivalent access rights to those of other parties. Interconnector capacity, to include capacity above 850 MW, that is not allocated in this way, or by a determination from the Director, would be available for use by the hosts' Generation businesses pending such allocation.
- 1.9 For ease of administration, the ability to request interconnector capacity would be limited to parties, or consolidators, with registered export generation capacity of 2 MW or more, so that the minimum allocation of interconnector capacity is 1 MW.
- 1.10 Ofgem added that it expected that purchasers of generation output in Scotland, primarily suppliers or consolidators, would be offered terms from generators whereby the purchaser would have the option to purchase contracts with or without some interconnector access.

South-north interconnector capacity allocation:

- 1.11 The August 2000 paper noted there are few constraints for flows south-north across the interconnector into the south of Scotland. Ofgem thus considered that the Transmission licensees should be able to fully accommodate requests for south-north interconnector capacity up to at least 1350 MW.

- 1.12 The August 2000 paper also noted that such capacity might be required by the system operators for imports in the event of a system emergency in Scotland. The paper said that Ofgem considered that this eventuality could be addressed through a contract condition in the Use of Interconnector Agreement between the Transmission licensees and the third party.
- 1.13 Further, the present arrangements for trading south to north, when the predominant flow is north to south, (superposition) would be retained.

Longer Term Arrangements

- 1.14 The August 2000 paper referred to the development of new transmission access and charging arrangements in England & Wales, including the creation of a Connection Use of System Code ('CUSC'). It proposed that GB transmission arrangements should be developed in parallel with those for England & Wales, and that a working group of industry representatives should be set up to take this forward.
- 1.15 The August 2000 document also contained interim proposals on interconnector pricing arrangements. These are not being taken forward in the paper but will be considered in phase II.

Section 2: Responses to August 2000 consultation paper

- 1.16 The twelve respondents, other than the host companies, who commented on the proposals in the August 2000 paper in general supported them as a step forward. Some confirmed the view expressed in the paper that administered arrangements were second best to the market alternatives of auctioning and subsuming the interconnector into the GB transmission system.
- 1.17 Some of the comments on the interim proposals are outlined below:

Access for generators and suppliers

- 1.18 One respondent noted there must be transparent and equitable access to the interconnector from the implementation date of revised Scottish administered pricing arrangements that use England & Wales imbalance prices. It added that if such access is not available then independent generators and suppliers will be

exposed to significant risks, without the ability to mitigate such risks by obtaining north-south interconnector access.

- 1.19 This respondent and another respondent supported the proposal that suppliers in Scotland should be able to obtain interconnector access through the purchase of generation. They agreed interconnector access rights should be based on generation capacity held under contract and not by ownership.

Access criteria

- 1.20 One respondent stated that competition would be restricted by constraining access to the interconnector to only 50 per cent of a generator's capacity. It noted that if domestic demand were satisfied then access to the interconnector by a third party, at 100 per cent of its capacity, would have no adverse impact. The respondent added that reserving to the host Generation business an equivalent capacity level to that awarded to a third party would not improve competition.
- 1.21 Another respondent felt that the allocation of interconnector capacity based on 50 per cent of third party generation capacity would act as a significant barrier to competition and the introduction of new renewables generating capacity.
- 1.22 This respondent suggested that renewables should have access to the interconnector for 100 per cent of their output. It noted that if interconnector trading were restricted to 50 per cent of output, new generators would almost certainly be dependent on the hosts to trade the remainder of their output in Scotland. Further it considered that small generators, below 2 MW, should not be excluded from the proposed interim arrangements.

Pre and post-Vesting capacity

- 1.23 Two respondents considered that the proposed method of allocation should apply to post as well as pre-Vesting capacity.

Secondary trades

- 1.24 One respondent indicated that the paper did not make sufficiently clear whether there will be a secondary market to trade interconnector access rights amongst participants.

Duration

- 1.25 One respondent asked that once the interconnector allocation had been made then, in the absence of BETTA, the same allocation arrangements should continue in subsequent years. It advised this would be important in terms of future investment decisions.

Consistency with other interconnectors' access arrangements

- 1.26 One respondent considered that the access and allocation arrangements on the interconnector should be consistent in both directions and should be identical to the proposed Moyle interconnector between Scotland and Northern Ireland.

Volume release from the NEA

- 1.27 British Energy said that if there were any volume release from the Nuclear Energy Agreement (NEA) prior to BETTA, then British Energy would expect to be treated as any other independent generator.

Longer-term: BETTA

- 1.28 In general, respondents supported integrating the interconnector into a GB wide transmission system as part of BETTA. However, one respondent NGC, suggested that unrestricted flows between Scotland and England could lead to planning standard non-compliance and the requirement for further reinforcement of the network, or derogation from the planning standard. NGC was concerned that, if a derogation was granted, the potential unrestricted flows between Scotland and England could lead to high constraint costs.

Host companies' views

- 1.29 Scottish & Southern Energy accepted most of the interim proposals, provided these operate for one year only. It noted that Ofgem's proposals retained the

current interconnector capacity allocation between the transmission business of ScottishPower and itself. Scottish and Southern Energy wished to apply the rule for third parties to access the "firm", pre-Vesting interconnector capacity only, with access to the "non-firm", post-Vesting capacity being retained by the hosts' Generation businesses.

Annual allocations

1.30 Scottish & Southern Energy suggested that:

- capacity allocations should be carried out on an annual basis, as the host companies may be commercially disadvantaged if they had already sold contracts into England and Wales based on an initial allocation; and
- capacity purchased year ahead, but not needed for the full year, could be traded through the Trading Code.

Premium prices for generation contracts with interconnector access

1.31 Scottish & Southern Energy, whilst agreeing with the proposal that suppliers should be able to gain interconnector access by virtue of their generation contracts, said such contracts may have a premium price.

Initial allocation of capacity: ScottishPower and Scottish & Southern Energy

1.32 ScottishPower proposed that the starting point for the initial allocation of interconnector capacity between ScottishPower and Scottish & Southern Energy should be the arrangements established at Vesting, rather than the position after the BNFL determination. ScottishPower added that the Vesting arrangements established the interconnector capacity allocations by reference to the generation capacities of the two companies. Under these, Scottish and Southern Energy agreed to allocate some 90 MW of its entitlement to BNFL. This arrangement expired and, in response to a request for determination, the Director determined in 1998, that BNFL's capacity entitlement of 196 MW should be made available from ScottishPower's interconnector capacity only.

Allocation of capacity to third parties

- 1.33 ScottishPower stated that it would be unacceptable for new applicants for interconnector capacity to affect ScottishPower or Scottish & Southern Energy disproportionately, as a result solely of where the applicant is located in Scotland.
- 1.34 It recommended that the Transmission licensees allocate interconnector capacity to third parties on an all-Scotland basis. ScottishPower suggested such arrangements could be introduced by agreement between ScottishPower and Scottish & Southern Energy or, if necessary, by licence modifications to introduce an all Scotland basis of allocation. It noted this would be consistent with the proposed longer-term arrangements.

Allocation criteria

- 1.35 ScottishPower said that the proposal that new applicants be entitled to firm capacity of up to 50 per cent of their generation capacity and that the host would receive a matching firm allocation would be acceptable for one year only. ScottishPower noted this acceptance was subject to the criteria being applied on an all-Scotland basis, and agreeable only because the amount of additional capacity that would be allocated to third parties was likely to be small.
- 1.36 ScottishPower also said that the Ofgem proposed arrangements were themselves discriminatory against ScottishPower's Generation business and could not be extended for a longer period, in the event of BETTA slipping beyond April 2002.
- 1.37 ScottishPower stated that its preferred allocation basis is to pro-rate access to the interconnector using generation capacity on an all Scotland basis, rather than use equal allocations between the applicant and host's Generation business as proposed by Ofgem.
- 1.38 ScottishPower also noted it would not accept that any resultant allocation of capacity to third parties as a precedent to assess what a party is entitled to under any follow on arrangements.

- 1.39 ScottishPower noted that it had withdrawn its application for a reservation on the post-Vesting interconnector capacity on the understanding that satisfactory arrangements for interconnector access would be agreed as a result of the review of Scottish trading arrangements⁵.

Longer term: BETTA

- 1.40 Both ScottishPower and Scottish & Southern Energy noted the considerable uncertainty about future transmission access proposals. Both reserved their positions until specific proposals are made.

Section 3: Subsequent relevant events

- 1.41 Since the publication of the August 2000 paper several events have occurred which are relevant to the Authority as it makes final proposals on interconnector access. These include, but are not limited to, those listed below.
- 1.42 In November 2000, Ofgem wrote to the two Scottish Transmission licensees seeking comments on a draft licence modification that seeks to establish the Access and Allocation Code as a Transmission licence requirement within the host's licences. Ofgem has received these and is considering them before undertaking a separate statutory consultation.
- 1.43 Ofgem notes the recent successful conduct of auctions of interconnector capacity between England and France, Scotland and Northern Ireland and Northern Ireland and the Republic of Ireland. Ofgem has requested the Transmission licensees to bring forward this month, preliminary thinking on the possible arrangements for auctioning the Scotland-England interconnector. This will inform Ofgem's consultation paper on phase II which will be published shortly thereafter.
- 1.44 The Authority has a primary objective of protecting consumer interests, where appropriate by promoting effective competition. On the introduction of the relevant provision of the Utilities Act 2000 later this year, the Scottish Transmission licensees will have the same duty as NGC to facilitate competition

⁵ see footnote 3

under Section 9 of the Electricity Act 1989. In addition, the hosts' are working to deliver business separation within the terms of the Utilities Act 2000.

- 1.45 The re-phasing of the introduction of NETA and transmission access proposals in England & Wales have delayed the development of BETTA.
- 1.46 In November 2000, a third party applied for north-south access on the interconnector in both host areas. One application has been withdrawn and the remaining application is outstanding.
- 1.47 In January 2001, one of the host Generation businesses applied to the Authority for a reservation of capacity on the pre-Vesting interconnector.
- 1.48 Ofgem has received comments from several parties that the commercial and technical arrangements and application process for importing into Scotland are not well documented.
- 1.49 ScottishPower has written to, and met with, Ofgem to re-iterate its disagreement with the proposed initial capacity allocation between Scottish and Southern Energy and itself and to seek to develop an implementation strategy for an all-Scotland allocation basis, using allocation criteria based on generation capacity in Scotland.
- 1.50 After due consideration of these events, in particular the introduction of auction arrangements on various interconnectors, and in line with Ofgem's preferred policy, Ofgem will bring forward a separate consultation paper on auctions arrangements on the interconnector. This is phase II of work to move to open, transparent and non-discriminatory access arrangements which, should also promote competition. Ofgem will also consult shortly on the request for a reservation on the pre-Vesting interconnector, referred to in paragraph 3.7 above.
- 1.51 On 23 February 2001, Ofgem issued a paper on the related issue of Scottish administered wholesale prices after NETA.⁶ This paper noted that fair and open interconnector access, combined with flexible contract forms in Scotland to facilitate cross-border trades, should improve competition in Scotland, in the

⁶ Revised Scottish Administered Pricing Arrangements February 2001 available from the Ofgem website and Ofgem library

period prior to BETTA. Thus, in time, effective competition from England & Wales should reduce the need for explicit regulation of wholesale energy trades between the hosts and independent suppliers in Scotland. Hence, Ofgem regards competitive access arrangements on the Scotland- England interconnector as essential for the development of competition in Scotland.

Section 4: Discussion of responses to Ofgem's initial proposals for interim administered access arrangements to the interconnector

- 1.52 Ofgem welcomes the general support for the August 2000 proposals for administered access criteria to be in place for a short duration before moving to GB transmission access arrangements. The purpose of these proposed arrangements is to facilitate access by third party generators to the interconnector, while also maintaining participation by third party generators in the Scottish market. It confirms there will be a need for some administered interconnector access arrangements that facilitate competition until more dynamic arrangements can be introduced.

Access for generators and suppliers

- 1.53 Ofgem agrees that generators and suppliers in Scotland, including the hosts, require transparent and equitable access criteria for interconnector access, which should be implemented as a matter of urgency.

Access criteria

- 1.54 Ofgem recognises that, assuming other generators meet all home demand, an independent generator may prefer to have an access rule which enables it to have interconnector access for 100 per cent of its capacity, rather than the proposed 50 per cent. This, however, is not necessarily a 'fair' rule and could be perceived as being unduly discriminatory against ScottishPower and Scottish & Southern Energy who also have substantial excess generation capacity, after meeting home demand. Hence, Ofgem will shortly consult on market based arrangements that move further toward the goal of open, transparent and non-discriminatory arrangements. It is important to keep in mind that there are interim arrangements prior to a move introducing enduring criteria.

- 1.55 In the interim period, a 50/50 allocation rule recognises that, in Scotland, capacity, net of demand (adjusted for a plant margin), is about twice the present level of interconnector capability. Applying this rule treats all third parties equitably and is consistent with the licensing arrangements established for ScottishPower and Scottish & Southern Energy at privatisation.
- 1.56 Ofgem does not agree that one consequence of the allocation rule is that new renewables generators will be dependent on the hosts to trade the remainder of their output in Scotland. The introduction of the Renewables Scotland Order should encourage other suppliers to seek trades with such generators. If contract forms present an obstacle to trade then this can be addressed as appropriate.

Pre and post-Vesting Capacity

- 1.57 Ofgem notes the two non host companies state that the proposed method of allocation should apply to all interconnector capacity, whilst Scottish & Southern Energy wish its application to be restricted to the 850 MW of pre-Vesting capacity. ScottishPower make no comment on this point.
- 1.58 Subsequently, a hosts' Generation business has applied for a reservation of pre-Vesting interconnector capacity. This followed a request from a third party for interconnector access.
- 1.59 The implementation of access criteria that affords no possible access to third parties, should the existing requests for interconnector usage be met in full, would be anti-competitive. Thus Ofgem concludes that all interconnector capacity should be allocated on a 50/50 allocation rule basis, rather than restricting the application of the criteria to pre-Vesting interconnector capacity only. This would facilitate open access for future third parties seeking interconnector capacity in ScottishPower's and Scottish & Southern Energy's areas.

Secondary trades

- 1.60 The Scottish Trading Code is established under a Scottish Transmission licence condition. This facilitates the trading of interconnector capacity and has been used by ScottishPower, Scottish & Southern Energy and BNFL for such trades. Ofgem expects these arrangements to continue beyond this change.

- 1.61 Ofgem expects the Trading Code to be augmented by a 'use it or lose it' condition so that unused third party interconnector capacity would be available for re-allocation to other users, to include the hosts' Generation businesses. This will be taken forward by the Transmission licensees through revised Access and Allocation Codes.
- 1.62 It will not request the Transmission licensees to bring forward other, more robust, arrangements since these arrangements are expected to have only a short duration.

Duration

- 1.63 Ofgem notes the proposed access criteria for allocating interconnector capacity are a first step towards open, transparent and non-discriminatory access arrangements. However, Ofgem shares many of the concerns of ScottishPower's and other respondents that these access criteria are not as conducive to the promotion of competition as we would wish. These are however, interim arrangements and represent a significant step forward towards the end goal of enduring arrangements. For these reasons Ofgem will be working with the host Transmission licensees to develop new arrangements. Ofgem will bring forward a relevant consultation shortly.
- 1.64 Ofgem intends that the use of administered arrangements will be superseded by market based arrangements within twelve months. As such the access criteria proposed in this document will apply until the earlier of the introduction of dynamic access arrangements or 1 April 2002.
- 1.65 Ofgem notes that both licensees may be willing to accept interim proposals, provided these operate for one year only. With their co-operation new arrangements can and must be introduced within one year.

Consistency with other interconnectors' access arrangements

- 1.66 Ofgem notes that auctions on the Northern Irish-Scottish interconnector have now taken place. Ofgem will wish to ensure that future arrangements for the interconnector facilitate cross-border trades across the various interconnectors.

Volume release from NEA

- 1.67 Ofgem proposed the allocation criteria on the basis that any volume release from the NEA, prior to establishing a GB market, is traded in Scotland only. Thus under the interim proposals British Energy would not get interconnector access. This approach was agreed with the parties to the NEA in order to simplify the re-negotiation of that contract. It is also consistent with the existing balance of contracts between ScottishPower and Scottish & Southern Energy.
- 1.68 All of British Energy's Scottish plant is located in ScottishPower's authorised area. Giving British Energy interconnector access on the same basis as other independent generators, under the administered access criteria, would be inconsistent with the privatisation arrangements which requires Scottish & Southern Energy and ScottishPower to contract for its output in the ratio 25:75.
- 1.69 Ofgem acknowledges that should radical changes be made to the NEA or other restructuring contracts, then further changes to the administered interconnector access rules would be necessary, namely a move to an all Scotland basis of allocation. Moving to market solutions to resolve interconnector access, in advance of such contractual changes, would make managing change easier.

Longer-term: BETTA

- 1.70 Ofgem notes NGC's concern that unrestricted GB trading under BETTA could lead to high constraint payments. Ofgem anticipates that the host Transmission licensees will bring forward arrangements that are consistent with their licence and statutory obligations. If so, the potential problem should not arise. However, Ofgem will monitor the situation.

Response to host companies' views

Annual allocations

- 1.71 Ofgem notes Scottish & Southern's suggestion that capacity allocations should be carried out annually, with unwanted capacity traded through the Trading

Code. Given the short expected duration of these criteria, being less than one year, this issue should not arise.

- 1.72 Ofgem agrees any unused capacity must become available to other parties. This can be achieved under the present Trading Code, supplemented by a 'use it or lose it' principle within the Access and Allocation Codes. Appropriate notification procedures will need to be consulted on and published by the host Transmission licensees.

Premium prices for generation contracts with interconnector access

- 1.73 Ofgem has considered Scottish & Southern Energy's point that generation contracts between itself and suppliers, which provide for interconnector capability, should be charged a premium, in comparison to contracts which do not provide such access.
- 1.74 Ofgem notes that existing generation contracts between the hosts and independent parties, in particular the NEA, contain no such premium. These contracts provide the hosts with generation for export. It would be inappropriate for the hosts to charge a premium price to third parties when they do not face similar charges. Ofgem, therefore, concludes that it would not be appropriate to charge a premium for generation contracts with interconnector access now, but will keep this under review as more competitive arrangements are introduced.

Initial allocation of capacity: ScottishPower and Scottish & Southern Energy

- 1.75 ScottishPower state that the initial allocation of interconnector capacity between ScottishPower and Scottish & Southern Energy, as at 1 April 2001, should require Scottish & Southern Energy to provide 90 MW of interconnector capacity, for BNFL's use. ScottishPower note that the BNFL determination included the following statement by the Director:

"ScottishPower has suggested licence modifications to restore the previous arrangements (which were established at privatisation whereby the capacity required by BNFL was made available from both the ScottishPower and Scottish & Southern Energy shares of the pre-upgrade interconnector). I would not rule out some changes in licence obligations with respect to provision of

Interconnector capacity in order to secure improved trading arrangements in Scotland"

- 1.76 ScottishPower added that its subsequent application for access on the post-Vesting capacity and withdrawal of the same was predicated on this statement and ScottishPower's assumption that revisions to the pre-Vesting capacity would be dealt with by revisions to the Access and Allocation Code.
- 1.77 Ofgem remains of the view that improving trading arrangements in Scotland, for example a move to auctions on the interconnectors, is likely to require some changes to licence obligations.
- 1.78 However, the present exercise is limited to seeking agreement on fair and open access criteria for the allocation of scarce interconnector capacity, under the existing licence and contractual framework. This issue has exercised Ofgem for some years. The absence of such objective, transparent allocation criteria may infringe the Directive. The revised arrangements are a step towards securing compliance with the Directive in Scotland.
- 1.79 Ofgem is of the view that it would not be appropriate to try to introduce licence changes when the proposed arrangements are only intended to endure until the earlier of introduction of dynamic arrangements or until 1 April 2002. Such measures would be disproportionate in these circumstances.
- 1.80 Ofgem notes that the existing arrangements for allocating interconnector capacity between ScottishPower and Scottish & Southern Energy were established at privatisation through the Scottish Interconnector Agreement, ("the Agreement"). This sought to provide both companies with adequate access to the England & Wales market to trade surplus energy and in the absence of Scottish trading arrangements.
- 1.81 The Agreement sets out the basis of allocating capacity between ScottishPower and Scottish & Southern Energy. The present allocations are determined in accordance with the Agreement.
- 1.82 Ofgem's locus on the Agreement is limited to agreeing modifications to it. Thus, if ScottishPower and Scottish & Southern Energy can voluntarily agree a contract modification, they can bring it forward for Ofgem's approval.

- 1.83 If change to the contract cannot be achieved voluntarily, then the regulatory tools available to Ofgem include a Fair Trading Act 1973 reference, or a Competition Act 1998 investigation. Scottish & Southern Energy has indicated its opposition to such contractual and licence changes. If Ofgem propose a licence modification which Scottish & Southern Energy cannot accept then the issue could be referred to the Competition Commission.
- 1.84 Any of these routes would take some months to complete, and, given the inter-relatedness of the restructuring contracts, would be difficult to ring fence to a review of this one Agreement. Any route would also take up considerable staff and financial resources for all parties. Ofgem judges in the short term, competition would be better served by using these resources to develop dynamic arrangements and thus will consult shortly on this subject.

Allocation of capacity to third parties

- 1.85 ScottishPower's second major point is that the present licensing framework, whereby it must respond to applicants' requests for interconnector capacity in its transmission area is unfair. It recommends that capacity be allocated from Scottish & Southern Energy and itself, to third parties, on an all Scotland basis.
- 1.86 Again, Ofgem would not object to the two companies bringing forward agreed proposals for the licence and contractual changes necessary to achieve ScottishPower's objective.
- 1.87 Ofgem does not consider that all-Scotland arrangements are a prerequisite for administered arrangements which are expected to have a short duration. Implementation of such change presents the same issues as those discussed in paragraphs 1.83 and 1.84, in terms of requiring changes to contracts and licences, given Scottish & Southern Energy's refusal to consent to change. Ofgem concludes that moving to an all Scotland allocation basis for provision of capacity to third parties should be considered when developing dynamic arrangements, but not for these short-lived arrangements.

Allocation criteria

- 1.88 ScottishPower suggests that Ofgem's proposed administered criteria are discriminatory against ScottishPower's Generation business. Ofgem agrees that

the proposals apply different rules to ScottishPower's Generation business to those applied to third parties, but does not agree or accept that this is discriminatory. The differences are objectively justifiable. In consequence, the proposals are that a third party generator will be able to gain interconnector access for up to 50 per cent of its registered generation capacity. This rule is not applied to ScottishPower's and Scottish & Southern Energy's Generation businesses as to do so, one could argue would be discriminatory taking account of their control of generation. Rather, these businesses receive the same allocation as third parties and may use all unallocated capacity, pending allocation under either the decision rule or by a determination.

1.89 Ofgem notes that ScottishPower and Scottish & Southern Energy are different from other participants. A few of the relevant differences between ScottishPower and Scottish & Southern Energy and other third parties seeking interconnector access are listed below:

- ScottishPower and Scottish & Southern Energy hold Transmission licences and have statutory duties with respect to facilitating competition;
- The Scottish licences treat the hosts and their affiliates differently from other parties in terms of awarding interconnector access;
- ScottishPower and Scottish & Southern Energy are vertically integrated and thus have a natural temptation to favour their affiliated functions;
- ScottishPower and Scottish & Southern Energy own or control 98 per cent of generation in Scotland and over 80 per cent of the supply market;
- ScottishPower and Scottish & Southern Energy are party to the various restructuring contracts, which govern interconnector access and generation purchases; and
- ScottishPower and Scottish & Southern Energy provide the imbalance function within their own authorised areas.

1.90 Competition law and relevant EC guidance on the management of interconnectors recognise dominance and vertical integration to be two relevant factors in forming policy. The occurrence of either feature may justify the

adoption of different regulatory mechanisms to those applied in circumstances where such features are absent.

- 1.91 Ofgem reviewed the proposed rules in respect of ScottishPower's concern. Ofgem considers that the different regulatory treatment proposed for ScottishPower and Scottish & Southern Energy, in comparison to third parties is justified because of, and not limited to, the differences noted above. It does not therefore accept that ScottishPower is being unduly discriminated against under the proposed interconnector allocation rules.
- 1.92 ScottishPower has proposed an alternative basis of allocation being generation capacity on an all Scotland basis. This would provide ScottishPower with a markedly larger entitlement to interconnector capacity than the proposed Ofgem criteria. If the ScottishPower criteria were applied, then a new entrant of say 100 MW would have an interconnector entitlement of 1 MW.⁷ This would not provide access to markets for new entrants and could be anti-competitive.
- 1.93 It is important to note in this context that Ofgem intends that the administrative rules will have a strictly limited duration. This reduces the potential exposure of ScottishPower to third party applicants. Ofgem will continue to monitor the situation and take account of representations made to it.

Views

- 1.94 Following careful consideration of all these responses and relevant events, Ofgem has set out in the paper its final proposals on interim administered interconnector access arrangements.
- 1.95 The host transmission licensees are requested to accept these proposals by 20th March 2001 and implement them from that date. Ofgem would welcome comments from any party on any issues raised in this paper or the appendix. Contact details are provided in the Executive Summary.

⁷ There is about 10,000 MW of generation capacity in Scotland