☰ Scottish and Southern Energy plc

Inveralmond House
200 Dunkeld Road
Perth PH1 3AQ

David Halldearn
BETTA Project
Office of Gas and Electricity Markets
9 Millbank
London SW1P 3GE

Tel: 01738 456400
Fax: 01738 456415

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Dear David,

Consultation on the form of TO revenue restrictions and consequential effects on NGC revenue restrictions

I am writing in response to Ofgem's Consultation on the form of TO revenue restrictions and consequential effects on NGC revenue restrictions. In general we agree with the proposed approach to the form of the TO revenue restrictions. We believe that the will produce a simple workable framework for aligning the obligations of the SO and the TOs under BETTA. There are still areas of detail to be worked out, for example the mechanism for the TOs to be funded for incremental infrastructure investment not anticipated in the price control.

Our detailed comments on each main heading are set out below.

Investment planning

It is a fundamental principle of the BETTA "model" that the transmission owners retain the right to decide if and when to invest in their networks. There is a general duty on transmission licensees under the Act to develop and maintain an efficient co-ordinated and economical system of electricity transmission. This duty will be underpinned by the licence itself and the SO-TO Code (STC) to ensure that any investment can be demonstrated to fulfil these criteria. Against this background, it is therefore clear that the TO is bound to carry out any investment that is economic. We firmly believe that the Act and licence framework will create the necessary obligation on the TOs to carry out any necessary investment.

However, the Authority also has a role stemming from its duty under the Act to ensure that licence holders are able to finance their activities. Currently the allowable revenue is based on expectations of investment that may be required during the next price control. It is therefore essential that the price control arrangements ensure that the TOs can fund any significant unforeseen investment.

We agree that it would be impossible to devise metrics to estimate the amount of investment required and calculate adjustments to the allowable income for any such investments. We also agree that it would be inappropriate for the TO and GBSO to negotiate the additional revenue requirements for the TO.

There is already a mechanism for TOs to seek additional funding for unforeseen investment requirements, and this has been use in the recent proposals to accommodate new renewable generation. We therefore agree that the existing mechanism for the licensee to seek additional revenues for any significant deviation from the expected investment level should be retained.

Outage Planning

Like investment planning, it is difficult to envisage a set of metrics which would enable standard levels of "availability" to be defined and to provide additional revenue to TOs for increasing the availability of the system (and reduced revenues for reduced availability). Outages are required for three main reasons:

1. maintenance of assets
2. capital projects to replace assets
3. capital projects for connecting new customers

The first two are known well in advance and are at predictable levels. They can be monitored against historic levels of activity and in any case are subject to price control revenue restrictions. The third is also known well in advance and the GBSO is involved in the connection offer and will therefore be aware of the outage requirements. Furthermore, the GBSO has a say in the timing of outages and there is an iterative process to optimise outages against the various cost factors. Also there is a mechanism for the GBSO to exercise emergency return to service options if an outage has to be curtailed, e.g. because of incidents elsewhere on the system. Given the detailed planning that goes into outage scheduling, it would seem reasonable for there to be a general obligation on TOs to use reasonable endeavours not to overrun outages.

Despite the above framework, there will be instances where a TO incurs additional costs as a result of decisions or requests from the GBSO. Since it would be impossible to set up metrics as discussed above, we believe it would be appropriate for bilateral negotiation between TO and GBSO to agree any payment from GBSO to TO to accommodate the GBSO requirements.

Transmission Switching

We agree that since the TOs simply act under directions of the GBSO in carrying out switching operations, there is no need for incentives for this activity.

Providing transmission Services

The STC is the document which specifies how transmission services will be supplied to the GBSO. It covers investment planning and outage planning and as such we agree that this activity does not require any additional obligations.

New Connections

We agree that post vesting assets should continue to be treated as an excluded service under BETTA. The GBSO will be exposed to the credit risk of the user, but this is entirely consistent with the principles of BETTA in that the TO has no responsibility for user-facing contracts. The same applies to exposure under the use of system charges.

Since the TO is entirely indifferent to the terms that NGC negotiates with the users, it is not clear why the payments by the GBSO to the TO should mirror the payments from the User to the GBSO. In E&W NGC pays the full cost of the connection work, and recovers the cost through the User facing contract on terms agreed between them and the user. To that extent the GBSO is already exposed to a difference in the way it funds connection work and the income from users. We therefore believe that NGC should simply pay the TO in full for the connection work. This simplifies the process and does not then require additional contractual arrangements between the GBSO and the TO.

Effect on NGC Incentives

NGC at present has two distinct price controls and incentives. The SO incentive relates to minimising the costs of balancing the system including managing constraints. The TO incentive relates to the costs of developing and maintaining the transmission network in England and Wales.

Clearly, under BETTA the SO incentive will need to be adjusted to allow NGC to recover the additional costs of balancing the Scottish System. NGC will have arrangements through the STC to enable it to configure the Scottish system to manage the power flows. We therefore agree that in normal balancing activities, there is no benefit in separating out the constraint costs for Scotland and applying different sharing factors. It should also be the case that payments to TOs to facilitate increased availability of their network (for example through the outage planning incentives discussed above) should come out of the SO incentive scheme. This ensures that incentives are aligned in this area.

NGC's TO incentive will not need to be revisited since this relates simply to the E&W system. However, NGC in its role as system operator will also be responsible for setting connection and uses of system charges across GB. It will therefore be necessary in setting these charges to aggregate the allowable incomes of the Scottish TOs as well as NGC's own TO business. NGC's price control will therefore need to be amended to allow pass through of the Scottish TOs' claims under their respective price controls in setting GB tariffs. This is identical to the way in which DNOs' price controls allow pass through of NGC exit charges in setting their DNUOS tariffs.

However, an area not specifically addressed in this consultation is the interaction between SO and TO incentive schemes. This problem exists under NGC's existing incentive scheme and is exacerbated under BETTA. For example, if constraints can be reduced by capital investment, NGC benefits in the SO incentive scheme but has to fund the capital investment until it gets assimilated into its asset base at the next price control. In other words NGC's benefit under the SO incentive is reduced by the cost of the investment.

However, under BETTA, it would be the TO that has to fund the investment, while NGC obtains the full benefit of reduced constraints under its SO incentive. As discussed above, the TO would be obliged to undertake the investment if it could be demonstrated to be economical, but NGC would immediately gain the full benefit of reduced constraints through its SO incentive scheme.

To resolve this issue, we propose that TOs should charge NGC's SO incentive scheme for incremental investments that have a payback period of less than 1 year. Incremental investments that have a longer payback period should also be charged to the SO, but these would be at a standard rate of say 10% of the investment cost until the next price control review, when the balance would be assimilated into the TO price control. This would have two benefits. Firstly it would avoid having price control reopeners and secondly, it would ensure that the correct economic decision is taken in carrying out new investment.

We do not believe that the Gt term is necessarily appropriate under BETTA. Co-ordinated investment planning will be required across GB and it has already been identified that significant investment is required by all three licensees to accommodate renewable generation. It does not therefore seem equitable to reward licensee A for connections in its area when the bulk of the investment might be in licensee B's area. This incentive is intended to facilitate infrastructure work by a licensee without revisiting the price control. If the mechanism described above were adopted, then this would not be required.

I trust you will find our response helpful in formulating the final proposals, but if you have any questions or require clarification on any of the above, please give me a call.

Yours sincerely,

Rob McDonald
Director of Regulation