DECC Consultation on the Implementation of the EU Third Internal Energy Package

Response from National Grid – October 2010

Question Responses

Chapter 1 (Consumer Protection)

**1) Consultees are invited to comments on Government proposals to implement the consumer protection measures of the Third Package.**

As noted in the Call for Evidence, it is our view that many of the consumer protection measures noted in the Third Package fall more within the remit of the energy suppliers rather than National Grid.

This said, we agree with many of the respondents to the Call for Evidence that the current arrangements in GB are largely compliant with third package provisions.

**2) In respect of the requirement to switch customers within three weeks, subject to contractual terms, we propose to put in place a new Licence Condition requiring the new supplier to give new customers a 14 calendar day period after the contract has been entered into, to consider whether they wish to proceed with this. Unless the customer notifies the supplier they do not wish to proceed, the Licence Condition will require the new supplier to give customers the right to change their mind within 14 calendar days and then be switched within three weeks, subject to outstanding debt (and, in the case of non-domestic customers, contractual conditions). Do consultees agree with this proposal?**

We believe that this is mainly an issue for the energy suppliers rather than National Grid.

As there is currently no obligation for suppliers to switch customers within a defined timescale, we believe that the government's proposed approach of imposing this as a new licence condition may be appropriate. Furthermore, as the 'cooling off period' offered by most energy suppliers is an important consumer protection tool in the UK, reflecting this in the switching timescales seems appropriate and is in keeping with the intentions of the Third Package. Under the Uniform Network Code, responsibility for administering the Supply Point Register falls on gas transporters. For the vast majority of supply points, (supply points on independent networks are administered by the relevant gas transporter), distribution network operators discharge this responsibility through an agency agreement with a centralised industry data manager, xoserve. xoserve receive, process and transmit all the data associated with these highly complex and automated supply point transactions.

While we welcome proposals to introduce regulations to provide timelier supplier switching, we believe consideration should be given to exactly which of the various steps in the supply point transfer process constitutes "customer switching". When a supply point switches, it is necessary for transporters to have a definitive view of the customer/supplier supply contract in order to update the central systems so that the shipper/transporter commercial arrangements, as set out in the Uniform Network

Code for transportation charging and gas balancing, are aligned with the supply contract.

The supply point transfer process managed by xoserve operates as follows. As well as fulfilling transporters' requirements to align UNC obligations and responsibilities with the correct shipper; it also facilitates the mechanism that allows shippers to object to the transfers for specific contractual reasons. Effectively, the xoserve managed supply point transfer process is two separate activities, the objection facility and the change to the supply point register; only after the former, "objection window", has expired can the second commence.

Prior to the transfer there are, in effect, two stages in the process where there is still some doubt whether or not the supply point will transfer, during the "cooling-off" period where the customer can change his mind and during the objection window where the incumbent shipper ascertains whether or not there are any contractual reasons for blocking the transfer. At present, the objection period commences once the acquiring supplier has submitted a notification to xoserve to confirm the supply point into its ownership. Once a notification is received, xoserve advises the incumbent shipper that a transfer request has been received and for the next 7 days the transfer is suspended while the incumbent shipper decides whether or not it would like to object to the transfer on permitted grounds. Therefore, as transporters, we can only complete the switch once the objection window expired.

Since all transfers are suspended for the objection period, we believe that consideration should be given to classifying the objection window as effectively resolving the "respecting contractual conditions" caveat in the legislation and should not be considered as part of switching process.

In any event, most supply points, even considering the objection window as part of the process, will (only just) transfer with the stipulated 3 weeks. However, should the objection window be determined without the 3 weeks, the pure supply point switching part of the process would have significant margin in it for meeting the mandate.

**3) Do consultees consider that the requirement on supply undertakings which are not registered in Great Britain, to provide a GB address for the service of the documents, poses any difficulty for these suppliers? Evidence of costs to these suppliers would be particularly welcome.**

National Grid considers that implementation of this requirement is likely to have a moderate financial cost associated with it for non GB based supply undertakings. However, we are not in an appropriate position to be able to provide an estimate of these costs.

Chapter 2 (Transmission and Distribution Networks)

**4) Do you have any comments relevant to our consideration of which unbundling models should be available in the GB market?**

*Paragraphs 2.15 to 2.17, Derogations:* We agree that it is for the government to decide which of the various options for unbundling it wishes to make available. We agree that the option of providing for the Independent Transmission Operator (ITO) model may be seen to be incompatible with the current arrangements, at least in relation to electricity, because the ITO model requires the ITO to undertake the full range of SO activities and does not permit the obligations to be discharged by a third

party. By contrast, the BETTA model involves SO functions for the Scottish transmission networks being undertaken by NGET as the NETSO.

We would also note that the implementation of the Independent System Operator ("ISO") model might itself appear to generate the need for a significant transfer of responsibilities from SPTL and/or SHETL to NGET in order to comply with the ISO model as defined in the Third Package. The responsibilities that would need to be transferred include planning (including authorisation procedures), construction and commissioning of the new infrastructure, granting and managing third-party access, and investment planning. As such, this "deep SO" model would have significant implications for the GB market arrangements currently in place under the BETTA.

*Paragraphs 2.18 to 2.21, Certification:* We agree that much of the material required for certification of TSOs is already set out in the Regulations. We would, however, seek to draw the Department's attention to the comments made by us in response to Ofgem's consultation on the "Certification of Transmission System operators under the Third Package" (a copy of which we have already shared with DECC) which sets out a number of areas in which we are unclear as to how some elements of the GB electricity market frameworks are compatible with the unbundling requirements of the Third Package. In particular, we consider that some elements of the framework maybe flawed, because they appear to represent an industry model that is not provided for by the Third Package (and, as such, prohibited). As stated in our response to that consultation, this issue appears to be particularly acute in relation to unbundled offshore transmission companies, but it could also affect Scottish Transmission companies were they to become unbundled and seek certification as TSOs.

*Paragraphs 2.8 - 2.13, Unbundling of TSOs:* We agree that it is relatively straightforward to agree an obligation in transmission companies' licences that prohibits them from holding any interest which puts them in breach of the unbundling requirements of the Directives. However, it will be more difficult to implement the rules prohibiting parties with a controlling interest in production or supply from holding or exercising shareholding interests in transmission licensees, unless this obligation is placed on parties with controlling interests in production or supply by making amendments to the Gas and Electricity Acts.

For example, it will be necessary to apply these rules to parties that currently benefit from an exemption from the requirement to hold a licence and, as such, it might be necessary to withdraw the availability of such exemptions from parties who do not comply with a requirement not to hold a "prohibited interest" (meeting the requirements of the Third Package) in a transmission licensee. This approach would place the onus for compliance with the party best able to manage it, rather than requiring the transmission licensee to attempt to monitor not only who all its shareholders are (a very difficult task for listed companies given the use of nominee holdings) but also other interests each and every one of those shareholders has.

Given National Grid's interests in the United States, we welcome the territorial limitation of any such legislation to control of ownership of undertakings which are actual or potential competitors in generation, production or supply in the EU in order to avoid the conflicts of interest addressed by the Third Package. We do, however, recognise that this might mean that some limited extraterritorial effect might be necessary to ensure effective implementation of the rules.

Specifically in relation to the enduring regime for offshore transmission, we agree that "...it is important that these unbundling requirements are introduced in a way that addresses the 'conflict of interest' concerns that they were designed to address..." We do not believe however that the current model for delivery of offshore transmission, i.e. a generator build option or the appointment of an OFTO, is

consistent with the necessary legislation given the requirements under Articles 9 and 12 to provide full System Operator functionality.

Currently the existing onshore Transmission licencees, who are capable of being fully compliant with the Third Package, are prevented (e.g through licence special conditions) from participating in offshore transmission construction and ownership. We believe that a hybrid approach to offshore transmission, which combines existing onshore Transmission licensees, generator-developer/OFTO led arrangements, offers a pragmatic, affordable approach to delivering the enduring offshore regime that is capable of being implemented in a manner compliant with the Third Package.

*Paragraphs 2.26 to 2.27, Tasks of TSOs:* As set out in our comments in the response to Ofgem's consultation on Certification of TSOs, we are concerned that the existing arrangements envisaged for the implementation of offshore transmission do not enable OFTOs to comply with the provisions of Article 12 of the Electricity Directive. Similarly Interconnectors, if designated as TSOs, would also be unable to comply. In particular, BETTA creates a TO/SO split for transmission licensees by:

1. placing the obligation on NGET to act as system operator ("NETSO") through the obligations in:
    - NGET licence Condition C16 (Procurement and use of balancing services) "to coordinate and direct the flow of electricity onto and over the national electricity transmission system in an efficient, economic and coordinated manner" (this also makes NGET's licence the "coordination licence" for the purposes of section 91(1) of the Energy Act 2004); and
    - the industry codes; and
2. limiting the obligation on the Scottish licensees in Condition D2 (Obligation to provide transmission services) to making available their systems available for the transmission of electricity, enabling the NETSO to configure its systems and complying with its directions and ensuring the NETSO has access to the required information. This approach is echoed in condition E15 (Obligation to provide transmission services) of the standard conditions of OFTO licences and further emphasised by the proposed Amended Standard Condition E12 - B2 (Activities restrictions for OFTOs) which prohibits them from co-ordinating or directing the flow of electricity onto or over the whole or any part of the national electricity transmission system except where permitted to do so under the STC, approved by the Authority, or where required another licence condition.

As such, under the present regulatory and commercial regime in the electricity industry (and the proposed offshore regime), only NGET can truly be said to have *"...responsibility for managing electricity flows on the system, taking into account exchanges with other interconnected systems..."* since it carries out this activity in respect of the whole of the national electricity transmission system pursuant to its licence and the industry codes. Indeed, it appears that only NGET can truly be said to be "responsible for" all the activities for which a transmission system operator is required to be responsible under Article 12 of Directive 2009/72/EC (the "Directive").

If OFTOs (or, indeed the Scottish transmission licensees) are unbundled and certified as TSOs, it appears that the scheme of regulation set out in the Directive requires them to be "responsible for" operating their own transmission systems in accordance with Article 12 of the Directive (specifically "managing electricity flows on the system" and "ensuring the availability of all necessary ancillary services"). However, as set out above, our understanding of the respective roles of NGET as NETSO and OFTOs under their respective licences appears to conflict with this. In particular, it appears that OFTOs cannot, by their licences, be required directly or indirectly to subcontract part of the SO function back to NETSO as this would appear to create a

model not provided for in the Directive. It would, of course, be open to OFTOs to choose to subcontract their SO functions (and the STC allows for subcontracting) but they must remain responsible for those functions in order to comply with the scheme of the Directive.

On this analysis, it would appear that the proposed extension of the BETTA model to offshore transmission systems (or unbundled Scottish licensees designated as TSOs) is flawed. We do not consider that any of the material published by DECC or Ofgem satisfactorily addresses or resolves these concerns. There are, we believe, alternative models that would better address these concerns.

By contrast, we note that if the "derogation route" is successfully pursued by SPTL and SHETL, the BETTA arrangements can continue to operate as they are in relation to the transmission of electricity onshore in Great Britain. However, if SHETL and SPTL pursue the "unbundling" route (as they are entitled to do) the same issues will arise in relation to the application of BETTA to Scotland as currently appear to in relation to offshore transmission.

*Paragraphs 2.28 to 2.30, Confidentiality*: We welcome the Government's acknowledgement that any changes to the confidentiality rules in the licences we hold will not prevent the use of common services by a company that carried out both distribution and transmission activities, but would note that our concerns run wider than just this narrow point. National Grid is concerned to see that the confidentiality rules imposed do not go any further than those set out in the Directives and, in particular, permit the use of common services across the full range of its business, subject to limitations only to address any of the concerns about the conflicts of interest which the Third Package is designed to address. As such, any confidentiality rules should not prevent the use of common services across gas and electricity as well as across transmission, distribution, storage, interconnector and LNG importation businesses.

**5) Do you have any views or concerns with how we intend to apply these new Third Package requirements on TSOs and DSOs?**

Please see response to question (4) above

We agree with the government's position that the designation of distribution system operators can be deemed accomplished by the existing licence regime, although some additional rules may need to be adopted to extend the rules to licence exempt undertakings. We also agree that distribution needs to be legally unbundled from production and supply, but not from transmission or storage.

Chapter 3 (Gas Infrastructure)

**6) Should the Gas Directive requirements for storage and LNG operators be introduced through a new licence regime or by amending existing legislation? Please provide evidence of costs and benefits wherever possible.**

We consider that the new rules concerning third party access should be set out in legislation, rather than through a new licensing regime. This approach will mirror the approach taken for the implementation of previous rounds of European legislation in this area and will avoid duplication, as well as avoiding the imposition of an unnecessary bureaucratic burden on LNG and storage operators. We do not consider that the downside of using legislation (i.e. that it's difficult to amend) is valid,

given that this approach has been adopted in the past and the frequency with which the European rules change is low and that the European Communities Act 1972 can be used to bring the changes forward.

We consider that the existing licensing regime is sufficient to effect designation of distribution system operators.

Chapter 3 Additional Comments:

Paragraphs 3.9 to 3.46, Third Party Access to storage and unbundling: We agree that the Government should continue to provide for the negotiated third party access regime for storage, but needs to be clear as to how the assessment of whether a particular facility is "technically and/or economically necessary" for providing efficient access to the system as provided for in Article 19 of the Gas Directive is made. We also agree that this assessment is best undertaken by Ofgem. We consider that an approach similar to that adopted by Ofgem in its letter of 16 June 2009 for making this assessment would be appropriate. However, we would caution against any approach to this assessment that might undermine the existing status of particular facilities, or which might jeopardise existing exemptions, for example by imposing storage third party access obligations on LNG terminal operators on account of gas being in storage prior to release to the networks.

Paragraphs 3.47 to 3.49, Confidentiality: We are concerned that some of the comments made in the consultation imply that Grain LNG is part of a vertically integrated undertaking (which it is not) and that confidentiality obligations might be imposed on it that would prevent the use by Grain LNG of common services with other parts of the National Grid group. We consider that such an approach would:

- drive inefficient outcomes and, as such, would not benefit consumers; as well as

- impose great practical difficulties on a party being able to take advantage of the right enshrined in Article 15 of the Gas Directive, to operate a combined transmission, LNG, storage and distribution system operator.

As such, we would echo the comments made above in relation to confidentiality for transmission system operators.

Paragraphs 3.58 to 3.61, Tasks of transmission, storage and/or LNG operators: We consider that the simplest way to ensure that all relevant licensees are responsible for the tasks set out in Article 13 of the Gas Directive would be to amend section 9 of the Gas Act 1986 to ensure that these general duties are applied to the required operators. This would be more straightforward and would make clear that these duties are placed appropriately in the "hierarchy" of obligations.

Chapter 4 (Role of the National Regulatory Authority)

**7) Implementing binding decisions. For the reasons we have set out, the Government proposes to replace the current collective licence modification objection arrangements with a process that allows Ofgem to reach its decisions subject to appeal to an appropriate body. This would reinforce Ofgem's power to make decisions in accordance with their powers and**

**duties under the Third Package, and would give all licensees the same right of appeal. Ofgem's decisions, as now, would need to be reached following consultation and subject to the principles of better regulation. This proposal would include all Ofgem licence modification decisions and not only those covered by the Third Package. We would be grateful for your views on these proposals.**

We are very concerned at the proposal set out in the consultation to remove the existing collective licence modification procedure and replace it with a system which allows Ofgem to impose a licence modification, subject only to a limited right of appeal. We feel that this proposal is unnecessarily broad in scope and will undermine the principles of good industry governance that have developed in the gas and electricity industries since privatisation.

We consider that there are four questions that are relevant to this proposal:

1. *Is this necessary?*
2. *Is this desirable?*
3. *What changes are necessary to implement the Third Package?*
4. *Can the Government's proposals be implemented other than by primary legislation?*

Taking each of these in turn:

1. Is this necessary?

We do not believe that compliance with the Directives inevitably leads to the Government being required to make the general change proposed to the licence modification rules. First, the requirements of the Directive only apply to the functions set out in the Directives. While these do include a duty to implement decisions of ACER and the Commission, they do not include all of the matters that could potentially be within the scope of licence conditions.

Furthermore, the consultation paper presents no evidence that the existing arrangements do not allow Ofgem to carry out the duties required by the Directive (or indeed to make any licence change) efficiently. This requirement in the Directives is vague and capable of interpretation within the discretion open to Member States. We consider that the present arrangements, by allowing consensus to be built, already meet this requirement, by avoiding lengthy disputes and appeals.

While the Directive requires a suitable mechanism to be available to allow a party affected by a decision of a regulatory authority to appeal to an independent body, it is not clear that this obliges Member States to make anything other than judicial review available, as it is at present to every licensee and interested third party, especially since the preceding provisions of the Directives refer to the giving of reasons to 'allow for judicial review'. It certainly does not enable DECC to draw the conclusion that the availability of judicial review is inadequate to meet this obligation.

In any event, the procedures for the current collective licence modification merely set a consensual bar which entitles Ofgem to impose a modification, but does not require any modification to be made: the decision whether to make the modification is made only after the objections have (or rather have not) been received after a final statutory consultation round. Judicial review is still available to all parties with the necessary standing after this decision is made.

2. Is this desirable?

We consider that the present approach, which ensures a broad measure of consensus is arrived at, reflects the notion that a licence is the property of its holder. As such, changing its conditions interferes with that property and therefore the regulator's powers need to be constrained. The use of a veto or blocking minority is a valuable right which this proposal will remove because Ofgem would be able to make any licence modification of its choosing, subject only to prior consultation. The proposal therefore reverses the current position since a licensee would be required to appeal in order to overturn a decision that had already been made by a regulator. Experience of even expert tribunals indicates that overturning regulators' decisions will be difficult because the tribunal is always likely to respect (and, therefore, to a greater or lesser extent, favour) the specialist regulator. As such, this represents a significant power shift towards the regulator with no commensurate check or balance which we think could be unlawful.

We are concerned that this change will inevitably lead to a shift in relations between the energy industry and its regulator as Ofgem will gain significantly more ability to direct and control the industry than it presently has. This will inevitably weaken the current discipline on Ofgem actively to engage with the industry in order to reduce the risk of references to the Competition Commission. This discipline promotes good regulatory practice and avoids legal disputes from developing, as Ofgem is encouraged to modify proposals to address industry concerns, even if the licence modifications which ultimately arise are not welcomed by the industry. As such, the proposed revised licence modification arrangements can only lead to more disputes and appeals than have been observed up to now, with an inevitable impact on the industry in terms of costs, uncertainty and delay.

3. What changes are necessary to implement the Third Package?

The implementation of the Third Package in Great Britain does require some changes to be made to the existing rules to ensure that Ofgem has all of the powers it needs, particularly to implement the decisions of ACER. However, this does not either require or justify re-writing the licence modification process for the reasons set out above. Even if it did, any such changes should only extend to the scope of the Third Package (i.e. limited to implementing the decisions of ACER), not the full range of matters covered by licence conditions (which is far wider). If this approach is adopted, licensees will retain the right to keep Ofgem within its power to impose changes beyond those necessary to implement the decisions of ACER, as such wider changes would exceed Ofgem's powers and be susceptible to judicial review.

4. Can the Government's proposals be implemented other than by primary legislation?

In the light of the above, the Government must limit the changes it makes to those it is entitled to if secondary legislation is to be used to implement the changes. These changes must not go beyond what is necessary in the scope of the Third Package: changes going beyond this would exceed the powers granted by the European Communities Act 1972.

As a result, the government must confine itself to a more limited set of changes confined to what is necessary to implement the Third Package, or must use primary legislation to bring about a broader change to the licence modification procedure: if this latter approach is to be adopted, the present consultation is a wholly inadequate means of seeking views on such a fundamental change to the licensing regime.

Chapter 4 Additional Comments:

*Paragraphs 4.32 to 4.38, Duties and powers of the regulatory authority:* We agree that Ofgem's oversight of transmission system operators needs to be extended to interconnectors, if the latter are to be designated and certified as TSOs as indicated in Ofgem's recent consultation on Certification. However, we would stress that the manner in which such obligations are applied to interconnectors needs to be proportionate, given the nature and scale of interconnector operations. For example, it would appear to risk imposing unnecessarily burdensome and bureaucratic obligations on interconnector operators for them to be required to comply with all the relevant obligations in the same manner as NGET as NETSO. As such, it may be appropriate to permit an interconnector operator to discharge some of its obligations through a TSO to which it is connected in order to ensure that the best party to discharge those obligations does so and to avoid duplication and unnecessary bureaucracy which does not benefit the operation of the market or consumers.

Chapter 5 (Cross border co-operation)

**8) Do you have any views or concerns with how we intend to introduce the regional co-operation elements of the Third Package?**

We are fully engaged with both ENTSO organisations. This can be demonstrated through the participation at management board level in both organisations, the secondment of staff into the ENTSOs, and the commitment we have already shown in not only attending workshops and other meetings, but in becoming a thought leader within the organisations. We have also been active within the ERGEG regional initiatives for both gas and electricity. These initiatives and particularly the gas regional initiative, are in need of an urgent review in order to ensure that they are effective in the post Third Package environment.

Regarding the DECC proposals to introduce new licence conditions in TSO licences to ensure continued cooperation, we would welcome more detail on exactly what might be proposed. TSOs are required, under the gas and electricity regulations, to cooperate through membership of the ENTSOs, and the ENTSOs in turn are required to develop processes for regional cooperation. It is therefore not currently clear that an additional Licence obligation for TSOs would add any material value. However and in relation to Interconnectors and irrespective of whether they are designated as TSOs or not, we believe that there is a need to review the Interconnector Licence arrangements to ensure the coordinated development of both onshore and offshore transmission requirements for new links and the provision of services necessary for the operation thereof.

We are fully supportive of Ofgem representing the UK in ACER