

# ENERGY ACT 2004

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## EXPLANATORY NOTES

### COMMENTARY ON SECTIONS

#### Part 3: Energy Regulation

#### Summary and Background

##### *Chapter 1: Electricity Trading and Transmission*

318. This Chapter provides a legal framework for a single competitive wholesale electricity market for the whole of England, Scotland and Wales. Specifically it allows for the implementation of the British Electricity Trading and Transmission Arrangements (“BETTA”).
319. Proposals for this Chapter were published for pre-legislative scrutiny in January 2003 as the Draft Electricity (Trading and Transmission) Bill. The House of Commons Select Committee on Trade and Industry published a report on the proposals in April 2003 and the Government’s response to its report on the BETTA proposals in July 2003. These publications can be found at:
- <http://www.parliament.the-stationery-office.co.uk/pa/cm/cmtrdind.htm> - reports
320. In order to deliver BETTA, arrangements are being proposed that are designed to promote the creation of a GB-wide wholesale electricity market, to create a single set of arrangements for access to and use of the transmission system and to create a single GB-wide transmission system operator. BETTA will also bring about the introduction of a GB-wide Balancing and Settlement Code (“BSC”), a GB Connections and Use of System Code (“CUSC”) and a GB Grid Code, which will mean a fully integrated and consistent set of rules in relation to connection to and use of the transmission system, and balancing and settlement, for the whole of GB. BETTA will also result in the introduction of a new code governing the interface between the system operator and transmission owners (an ‘SO-TO’ Code).
321. The main statute regulating the electricity industry is the [Electricity Act 1989 \(c.29\)](#) (the “Electricity Act”). Section 4 of the Electricity Act prohibits anyone from carrying out certain activities unless licensed or exempted from the requirement to be licensed. There are four types of electricity activity that are prohibited by the Electricity Act, and therefore licensable – generation, transmission, distribution and supply. In relation to electricity transmission there are currently three licences in GB, held by the National Grid Company, covering England and Wales, Scottish Power Transmission Limited and Scottish Hydro Electric Transmission Limited.
322. The Gas and Electricity Markets Authority (“GEMA”), supported by Ofgem (the Office of Gas and Electricity Markets), regulates the gas and electricity industries in Great Britain. Its powers are provided for under the [Gas Act 1986 \(c.44\)](#) (the “Gas Act”), the Electricity Act and, most recently, the [Utilities Act 2000 \(c.27\)](#) (the “Utilities Act”). The Electricity Act (section 6) provides for GEMA to grant licences for each of the four prohibited activities. Each licence has an accompanying set of Standard Conditions that set out the obligations and duties that each licensee must adhere to. In addition each

licence may include specific or special conditions applicable to a particular licensee. It is also GEMA's role to enforce any breach of these obligations.

## **England and Wales**

323. England and Wales currently operates as a single wholesale electricity market. The New Electricity Trading Arrangements ("NETA") came into effect in March 2001, replacing the Electricity Pool. The Pool was a relatively centralised market that determined the wholesale price of electricity. The trading arrangements under NETA, in contrast, are based on the bilateral trading of electricity contracts between generators, suppliers, traders and customers. They operate as far as possible like other commodity markets with a forward and futures market that allows contracts for electricity to be struck well in advance and for short-term power exchanges which give participants the opportunity to 'fine tune' their contract positions. The Government, and Ofgem in particular, have continued to work closely with industry, through consultations and other means, to improve the mechanisms in place under NETA to ensure it works as effectively and competitively as possible. A brief overview of NETA is also available on the Ofgem web site.

## **Scotland**

324. The arrangements put in place under NETA did not encompass Scotland. At the time of privatisation, the wholesale trading arrangements that were put in place in Scotland were significantly different to those in England and Wales. As a result the Scottish market has only two main players. The key features of this structure are:

- Two vertically integrated groups, ScottishPower and Scottish & Southern Energy, who retain interests in generation, transmission, distribution and supply;
- The allocation of virtually all Scottish generating capacity, through ownership or contracts, between ScottishPower and Scottish and Southern Energy;
- Duopoly control over the bulk of interconnector capacity with England & Wales.

325. The result of this structure is:

- In Scotland GEMA administers prices because competition is underdeveloped and the market offers much less choice for both industrial and domestic consumers;
- Current market arrangements make it difficult for independent Scottish generators to connect to the grid and sell to the wider GB market. This hinders competition and is a barrier to achieving the Government's renewables target of 10% by 2010.

## **Europe**

326. The Lisbon European Council in March 2000 agreed to accelerate energy liberalisation with the ultimate objective of a fully open internal electricity and gas market. This was followed in March 2001 by proposals from the European Commission for new Electricity and Gas Directives and a Regulation on cross-border trade in electricity. Political agreement on these proposals was reached at the Energy Council on 25 November 2002.

327. The new Directives require, among other things, independent regulation, transparent, non-discriminatory access to infrastructure, the unbundling of vertically integrated monopolies and for all consumers to choose their electricity and gas suppliers by July 2007. The Regulation establishes a mechanism for developing cross-border trading arrangements.

328. The Government strongly endorses these measures, which it believes are essential prerequisites for a properly functioning internal energy market. BETTA will allow us to

apply even greater pressure on our European partners to implement the changes agreed in the Directive in terms of opening their markets and increasing competition.

### **Main provisions**

329. In summary, this Chapter provides for:

- a power for the Secretary of State to amend electricity licences; to enable the implementation of a single British transmission system and a single system operator; and to allow for a single set of trading arrangements and a single set of arrangements for access to and use of the transmission system, modelled on those currently operating in England and Wales, to be extended to the whole of Britain;
- changes to the prohibition on transmitting electricity. In simple terms this will re-define what the prohibition covers. Section 4 of the Electricity Act defined what was meant by transmitting electricity and made it illegal to undertake such activity without an appropriate licence. As a result of the proposal to introduce a single system operator for Great Britain, the Act will amend section 4 in order to ensure that the licensable transmission activity covers separate components:
- the co-ordination and direction of the flow of electricity across the whole transmission system i.e. an activity of the transmission system operator, and
- the making available for use for the purposes of such a transmission system of anything which forms part of it.

This reflects the fact that both the system operator and the transmission asset owners will have an important role to play in the process of transmission under the new arrangements;

- A power for the Secretary of State to instruct GEMA to award a transmission licence;
- Changes to the licensing powers contained in the Electricity Act to reflect the two transmission functions as outlined above;
- Other changes to the Electricity Act consequent upon a single trading market and revised transmission arrangements;
- A licensing scheme so that existing transmission licences will become transmission licences under the amended prohibition on transmission;
- A scheme to enable the transfer of certain assets to the transmission system operator in order to enable it to carry out its activities effectively in the event that the transmission licence holders concerned cannot agree the need for, or aspects of, the transfer amongst themselves.