

Transmission Access Review

Enhanced Transmission Investment Incentives: Initial Proposals

Response by SP Transmission Limited

This response is from SP Transmission Limited which, as the regulated Transmission Owner, owns and maintains the electricity transmission network in south Scotland.

Reinforcing the GB transmission system is an absolute priority if the Government's 2020 targets are to be met. The three Transmission Owner companies have worked well together, with many other stakeholders, to coordinate robust and sensible plans for increasing capacity on the GB transmission system. What is now required is a clear regulatory framework based along existing lines but which works more quickly and effectively to allow the pipeline of projects to advance in time to achieve these targets. We see no compelling reason for a radical departure from the current transmission price control design, which provides investors with as much certainty as can be expected that timely, cost-efficient investment will be fully funded. Ofgem's proposals in this consultation, where funding is provided from one year at a time through to 2011/12 (or 2012/13 if there is a roll-over), do not provide the certainty that is needed.

Our other main points are:

- We are very disappointed that the series compensation project to increase the capacity of the SPTL-NGET Interconnection has not been categorised as 'strong certainty'. This project has a clear need case, limited consenting risk and can be delivered at a low cost per MW compared with other reinforcements. In order for our construction works to start in 2010 we require urgent agreement that this project will be funded.
- Necessary and cost-efficiently incurred pre-construction costs should be fully funded and treated as "opex".
- The requirement for short-term funding arrangements to be reflected in supplier procurement contracts will complicate these contracts and increase costs.
- The current capex efficiency sharing factor of 25% should be retained.

The attached appendix provides our answers to the specific questions raised by Ofgem.

SP Transmission Limited
1 December 2009

CHAPTER: Two

Question 1: Do respondents consider we have appropriately summarised the views of respondents to our September consultation?

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Question 2: Do respondents have any comments on the initial findings of our consultants or views on the issues raised by the TOs?

We expect Ofgem's consultants to conclude that the major reinforcements in and from SPTL's licensed area have clear need cases, and that our engineering designs are appropriate and cost-efficient.

Series Compensation Project to Upgrade the SPTL-NGET Interconnection

Given that the need case to reinforce the SPTL-NGET interconnection is obvious, we are very disappointed that Ofgem and their consultants have not confirmed the need case and the engineering solution for the series compensation project. We find it difficult to understand why this project has been categorised as "reasonable certainty" rather than "strong certainty". This project can be delivered at a low cost per MW compared to other interconnector upgrades and has limited risk around consents. We assume that this decision is due to the consultants late involvement in this assessment process rather than a weakness in the need case for this project and we expect Ofgem to conclude that this project is 'strong certainty'.

In order to minimise constraint costs during construction, we propose to make use of the interconnector outages commencing in spring 2010, which have been booked by NGET for the TIRG 2800MW upgrade east coast works. We therefore require urgent agreement on funding in order to ensure that supplier contract arrangements are in place by January 2010, at the latest, in order for contractors to start work in spring 2010. Failure to take advantage of this outage opportunity will mean additional interconnector outages in 2011 at significant additional constraint cost (estimated at over £20M).

West Coast HVDC Link

We are surprised at the comments in 2.31 that "there is uncertainty over the level, timing and location of the expansion required" for the West Coast HVDC link. Since the ENSG report was published, we have seen even more renewable activity in Scotland such that it is now acknowledged that the Gone Green scenario of 11GW of renewable generation in Scotland is now regarded to be the median view. The need case and the timing of this link should be confirmed.

We have two comments on Table 2.1 on page 15:

- Relating to Planning Consent stated as '> mid 2012', although we recognise the uncertainty around planning and consents, we believe this is a pessimistic view. We are currently seeking advice on the planning process, which is complicated by changes to marine consenting regime in Scotland and England and Wales, and we will have a clearer view of our position in the near future.
- Relating to Technical Readiness stated as '>2yrs', our current programme including early contractor engagement will (subject to the funding of pre-construction works) have completed designs and be ready to place the detailed design and construction contracts by late 2011.

CHAPTER: Three

Question 1: Do respondents have any comments on our proposed funding framework for additional investment within TPCR4?

Investment certainty is a fundamental building block. It is very difficult for any business to fund its investment requirements when project funding is given for one year at a time. The TOs must have confidence that the investment framework allows them to plan and invest beyond the short-term investment horizon proposed in this consultation.

Question 2: Do respondents have any views on the appropriate funding mechanism for provision of pre-construction funding?

We believe that necessary, cost-efficiently incurred pre-construction costs should be fully funded and treated as "opex".

Given that the ENSG reinforcements are complex technical projects that involve considerable parallel work around HVDC, series compensation and wide area monitoring systems, and that we were required to prepare pre-construction cost forecasts at an early stage in the process, we do not agree that we should be incentivised on pre-construction. We believe that pre-construction costs that can be demonstrated to be necessary and cost-efficiently incurred should be allowed.

We recently notified Ofgem that we omitted SPTL's pre-construction costs for the onshore works associated with the joint SPTL-SHETL Hunterston-Kintyre project. These pre-construction costs are forecast at a total of £0.5M over 2010/11 and 2011/12.

Question 3: Do respondents have any views on our proposed approach to identifying projects eligible for construction funding?

The fact that Ofgem has not designated the onshore series compensation project to reinforce the SPTL-NGET interconnection as 'strong certainty' leads us to question effectiveness of Ofgem's proposed approach.

Ofgem makes frequent references to the requirement to "invest ahead of signalled need". Given that the need case has been clearly demonstrated for the main reinforcements in and from our licensed area, there is no requirement to enter into complex incentive arrangements to invest ahead of user commitment. The incentives should be based around timely and cost-efficient delivery, and we recommend that these should be based around the current price control arrangements.

Question 4: Do respondents have any views on our proposal to fund construction costs up to the end of TPCR4 for specific projects? Do respondents agree that it may be appropriate to provide funding up to an earlier end date for projects in certain circumstances?

Reinforcing the GB transmission system is an absolute priority if the UK Government's renewable energy requirements are to be met. The three Transmission Owner companies have worked well together, with many other stakeholders, to coordinate robust and sensible plans for increasing capacity on the GB transmission system. What is now required is a clear regulatory framework based along existing lines but which works more quickly and effectively to allow the pipeline of projects to advance in time to achieve the Governments 2020 targets.

To achieve this, we see no compelling reason for a radical departure from the current transmission price control design, which provides investors with as much certainty as can be expected that timely, cost-efficient investment will be fully funded. Ofgem's short-term, piecemeal proposals in this consultation, where funding is provided from one year at a time through to 2011/12 (or 2012/13 if there is a TPCR5 roll-over), do not provide the level of certainty that is required.

Certainty around the nature of the price control mechanisms is more important than ever given current market conditions and the scale of infrastructure investment opportunities on the current horizon that investors can choose from. In the current environment, investment certainty is a fundamental building block. The short-term investment horizon proposed in this consultation may disincentivise investment and lead to delays.

Supplier Procurement Contracts

In paragraph 3.32 we note that Ofgem expects the TOs to ensure that their contracts with suppliers incorporate appropriate revision arrangements to permit the variation and termination of these contracts. This requirement will increase costs particularly given that many of the supplier contracts will be for high cost, long lead-time items.

Pass Through of Incentivised Costs

In the current climate in which we are seeing marked increases in input prices, we do not agree that the shortened lead-time between agreement of the funding allowance and expenditure against allowance reduces cost uncertainty. Hence, the current capex efficiency sharing factor of 25% should be retained. We note that Ofgem is proposing a risk profile for transmission that will, in practice, be above the risk profile of any of the distribution companies.¹

Question 5: Do respondents agree that the same rate of return should apply as for other investment undertaken within TPCR4?

Ofgem should provide a stable, enduring investment framework that avoids unnecessary and complex incentive arrangements around user commitment. Under a stable framework, there would be no need to change the rate of return.

Question 6: Do respondents have any views on the appropriate treatment of projects beyond TPCR4 or on any interaction with our decision on the timing of TPCR5?

Investment certainty is a fundamental building block. The transmission companies must have confidence that the investment framework allows the companies to plan and invest beyond the short-term investment horizon proposed in this consultation. We understand that a key driver for Ofgem wanting to extend TPCR4 through a one-year roller is the RPI-X@20 project. The limited progress that has been made so far on this project is a concern and raises the question as to whether this project will actually complete in time to line up with the start of TPCR5. Indeed, the reference in this consultation to the project providing a “framework and process” implies that the project may not lead to real changes to the regulation of the transmission companies.

Question 7: Do respondents have any comments on any other aspect of our Initial Proposals?

Competition

Given the level of onshore and offshore network investment required to deliver 2020, all approaches to investment financing and timely delivery must be seriously considered. However, it is important to note that we are working with all the main suppliers in the industry already and that for all of the transmission investment undertaken by ScottishPower around 80% of the construction activity is outsourced to the market. Hence, we would argue that competition in the construction phase is already facilitated through our existing procurement arrangements. Further, we have seen little evidence to suggest there is a huge appetite in the external market to take on cost and risk of design, construction and full asset ownership and question whether or not this would drive sensible economic development of the UK transmission grid going forward.

¹ As set out in the DPCR5 Initial Proposals.

CHAPTER: Four

Question 1: Do respondents have any views on our proposed approach for taking forward our work on TO incentives to facilitate further investment within the current transmission price control?

Impact on TNUoS Charges for 2010/11

In our annual process under the STC to notify NGET of our general system charges we have tried to take account of this consultation process. As Ofgem is aware, our final notification deadline to NGET for the next changing year is at the end of January hence it is important that we agree the funding arrangements well before this deadline.

Licence Modification Process

The Licence modification process is very important given that it takes time under the current process to design, assess and implement Licence changes.

Question 2: Do respondents have any views on our proposed consultation process going forward?

For the consultation process going forward, Ofgem should focus on providing a stable, enduring investment framework that avoids unnecessary and complex incentive arrangements around user commitment. The framework must provide the transmission companies with confidence that they can plan and invest beyond the short-term investment horizon proposed in this consultation.

We understand that a key driver for Ofgem wanting to extend TPCR4 through a one-year roller is the RPI-X@20 project. The limited progress that has been made so far on this project is a concern and raises the question as to whether this project will actually complete in time to line up with the start of TPCR5. Indeed, the reference in this consultation to the project providing a “framework and process” implies that the project may not lead to real changes to the regulation of the transmission companies.