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Dear David

Response to the DTI/Ofgem consultation on Transmission charging and the GB Wholesale Electricity Market

Scottish Renewables Forum is Scotland's leading renewables trade body. We represent over 85 organisations involved in renewable energy in Scotland. We have the following points to make on the above consultation. Further information about our work and our membership can be found on our website.

Scottish Renewables Forum supports the principles behind the BETTA project. However, we have concerns about how the needs of BETTA must also reflect the aspirations of UK Government renewables policy. We welcome this attempt by Ofgem/DTI to balance these two considerations.

However, we have our own recommendations about what we see as the correct way to balance these concerns.

Firstly, we would like to note our continued frustration that the Ofgem consultation on smaller generator issues has still not been released. In February of this year - on behalf of Ofgem – you personally assured the Trade and Industry Select Committee that the consultation would be released by April 2003, so that conclusions on smaller generator issues could be reached by June.

However, seven months later no smaller generator consultation has materialised, yet issues that need to be resolved through this are key to other parts of BETTA.

To assist with this Scottish Renewables sent through a Scottish position paper on the "132 issue", but have not yet received any formal response or feedback from this. I would like to use the opportunity of this response to again recommend this position to you and urge you to adopt it as part of BETTA reforms.



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Returning to the issue of transmission charging, we have responses to make on two key issues.

1. Licence Conditions and Price Mechanisms

We feel that it should be explicitly recognised that the combination of BETTA and the development of new renewables means that the way in which the GB grid works will change fundamentally over time.

The proposed System Operator (SO) role will give substantial power and control over a part of our electricity industry that is fundamental to successful working of ALL other parts. This means that any licence and pricing mechanism that is adopted should reflect the ability of the SO to deal with UK Government policies and targets that impact on the electricity market. Key in our thinking is of course UK Government and Scottish Executive renewables policy.

We agree that the main driver in the SO's terms of reference should be cost effectiveness of grid management and development. However, this must be balanced to ensure that renewables policy must be taken into account. Connection of new renewables should therefore be thought of as carbon reduction, and Ofgem and the SO tasked with ensuring cost-effective carbon reduction. This approach will fit into Ofgem's primary role of cost effectiveness, while preparing the GB regulatory market for the onset of carbon trading.

Therefore, the licence conditions must be changed to reflect a wider role, so that where the transmission system is the most effective way to deliver UK Government policy, NGC is tasked and enabled by the regulator to fulfil this delivery.

Price Reviews

It should be noted that the result of these licence changes will lead to vastly centralised power structures and industry control within Ofgem and NGC. This leads to potential concerns about price changing, and the associated impression of regulatory risk.

While the Five Yearly Price Reviews are well structured and provide for consultation with industry, the Licence proposals provide for no involvement with industry if NGC-Ofgem wish to change pricing between these Five Yearly Reviews.

We would therefore call for a requirement that any proposed changes to pricing must be consulted with industry (for example using the existing CUSC Panel), and that there should be a right of appeal to the Government on decisions made by Ofgem or NGC. Such provisions will provide for a more acceptable balance of power between the regulator, grid operator and grid users, while reducing regulatory risk.

2. Scotland's role in renewables and tackling peripherality

This consultation recognises the key role of Scotland in delivering UK Government targets on renewables, and we welcome consideration of mechanisms to avoid discrimination of renewables generation in Scotland. However, the proposed mechanism of rebates and/or peripheral signals based on population density will do

little to help create an easily understandable market framework, while avoiding criticisms of “meddling” in the market that will drive away the investment community.

In effect Ofgem is attempting to set up two sets of price signals, which is akin to having two sets of traffic lights at a road junction. There is the potential for the signals to work out of phase and therefore produce an effect counter to the intended one.

Crucially, it is our view that the Ofgem-DTI proposal will NOT lead to cost reductions to the consumer or ensure ongoing security of supply in Scotland.

Ofgem-DTI favour a charging rebate that reflects peripherality. The recommended mechanism is to give a rebate to renewables generation in areas classed as peripheral by dint of population density.

We would see this definition as wholly inappropriate to smooth running of an electricity system, as peripherality in electricity trading has almost nothing to do with population density, and is therefore a crude lever.

Including Highlands & Islands while leaving out other areas of Scotland, will encourage development in one area, while frustrating it in another, yet the cost of transporting that power to market could be almost equal. For example, distance to market of a generation site in Aberdeenshire will almost certainly be greater than that in parts of the SW Highlands. If this definition of peripherality is adopted there is the danger of concentrating developments in one part of Scotland, instead of sharing the benefits and consequences of renewables developments.

Instead we would encourage adoption of a definition of peripherality (and consequent charging) that is based on the working of the grid. Our chosen way of achieving this would be encouraging regional balancing of load and generation.

Ensuring regional security of supply

It is our view that Ofgem need to satisfy itself that any adopted charging mechanism reflects the reality of operating the GB Grid. For example, a charging methodology needs to understand that balancing the grid is not simply about managing disparity between consumers in Southeast England and generators in Northern Scotland.

Ofgem also need to note that the planning system(s) are unlikely to allow sufficient generation to take place near key load centres in GB.

This means that charging methodology needs to support generation in sites where it is practicable, and ensure that it is not penalised. Key generation areas for GB are the two DNO areas of Scotland. Badly structured price signals could make it prohibitively expensive to run generation in Scotland. This would threaten security of supply within each demand area, leading to problems of providing sufficient economic baseload generation in local areas.

For example, within the Highlands, the model currently proposed would penalise efficient local based generation such as the Peterhead power station. Giving the wrong signal to operators of stations such as Peterhead could cause generation to “migrate” over time, and lead to closures of such stations.

Capping TUoS charges

To ensure continued local security of supply we would recommend that a maximum TUoS charge is set – effectively capping the charge. This allows for locational charging, while ensuring that charges must be reasonable.

We have discussed this issue with conventional generators and are of the view that conventional Scottish generation could withstand a maximum of £12 per kW per annum positive change. We therefore conclude that this be set as a cap for conventional generation.

Furthermore, it is our view that the TUoS charge for renewables should be capped at the average GB TUoS price. Again, this would allow for locational charging, while ensuring that the charge is reasonable and does not penalise peripheral renewable generation.

Finally, we note the concern expressed about ensuring compliance with forthcoming European legislation. We note that there are conflicting requirements here, and balancing such requirements will be difficult. It is our view that the mechanism we have proposed more closely meets the disparate expectations of European legislation, and would therefore be less likely to be challenged within the European courts or called in for review by the EU.

The role of Renewable Obligation Certificates

The consultation discusses how transmission charging or rebates might be used to support or add value to the two ROC mechanisms (ie. England-Wales and Scotland). However, we would caution very strongly about bringing in new price signals that could be seen as “ROC management”. The market is already wary about the long term viability of the ROC as a tool to support future renewables, and preliminary feedback from the Renewables Advisory Board’s finance study shows that the finance community is of the view that the Regulator and Government have a reputation for “fiddling not fixing”.

It should be remembered that the key to successful renewables development is achievement of healthy long term power purchase agreements (PPAs). ROCs are a part of this, but in signing a PPA the ROC value is discounted by the supplier. Therefore any rebate is also likely to be discounted in the same way, as part of the negotiation of signing PPAs. This means that the value of the rebate would have to be set higher than needed, leading to extra cost for the consumer.

It is our view that the proposal to help underpin ROCs through introducing some kind of rebate system is akin to fiddling with price mechanisms and will lead to the (unintended) effect of reducing investor confidence.

We would therefore urge adoption of a more holistic solution that seeks to bring locational charging and support for renewables into one mechanism.

Further issues on supporting Renewables

Regarding renewables and other comments and proposals within the consultation, it is the view of Scottish Renewables Forum that we are unable to respond effectively at this time.

This is because we are hamstrung by a lack of information or clarity from Ofgem and DTI on other key issues.

It is a sad fact that we have insufficient information to comment effectively until we have had clear guidance from Ofgem on:

1. the definition of 132kV lines in Scotland
2. clarity on treatment of smaller generators
3. certainty in DUoS charging out of the current DNO review

Potentially, the effect of these three issues (when resolved) could combine to sterilise development of further renewables in Scotland, so at present we see a high level of regulatory risk associated with new renewables in Scotland. This is a matter of great concern to the energy and finance industries.

Given that one of Ofgem's stated objectives for BETTA will be that *"renewable and other generators, particularly in Scotland, will benefit from access to a wider market"* we would hope you take seriously our increasing concern that BETTA could have the opposite effect. Until such issues are resolved – primarily through the smaller generators consultation – it will be hard to avoid any other conclusion.

In summary

- a) It is key that licence conditions imposed on the System Operator (SO) should enable the operator to fulfil wider Government objectives, though cost-effective grid management should remain their primary concern.
- b) To balance the interests of the different parties, and to reduce regulatory risk, there should be sufficient consultation and rights of appeal – particularly in relation to price changes.
- c) It is our view that setting caps on Transmission Use of System (TUoS) charges for conventional and renewables generation will bring a more equitable charging regime than that currently proposed, and give a better balance between cost effective grid development and achievement of GB renewables targets.
- d) Finally, we see this charging mechanism as supporting signals such as the ROC mechanisms, rather than undermining confidence in them, therefore helping increase investor confidence in the renewables market and the respective roles of the regulator and government within this market.
- e) However, we feel that we have not been able to contribute fully to this consultation given continued lack of information from Ofgem about how they see smaller generators working within BETTA.

If you require any further information or would like to discuss the views set out further, we would welcome the opportunity for further discussion.

Many thanks for your time and consideration and we look forwards to the response from Ofgem-DTI to this consultation.

Yours sincerely

Maf Smith
Development Manager