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Dear Jonas

TRANSMISSION INVESTMENT FOR RENEWABLE GENERATION

NGT welcomes the opportunity to respond to Ofgem's second consultation on the issues associated with funding the additional investment needed to reinforce the transmission networks to accommodate renewable generation. The consultation requests views in a number of areas. Our response addresses these in the order summarised in Chapter 7.

Price control adjustments

Ofgem has identified several ways through which the transmission price controls could be adjusted to fund transmission investment for renewable generation between 2004/05 and 2006/07. We welcome Ofgem's proposed approach to develop an "add-on" to work alongside existing controls and believe any adjustment mechanism should consider the investment required over the three-year period identified, such that investment is both efficient and timely to support the deployment of renewables.

In developing the mechanism, we believe Ofgem should take a pragmatic approach to enable the transmission companies to undertake the investment required to allow renewable generation to connect within the timeframes necessary to reach the Government's environmental targets. We agree with Ofgem's view that the mechanism should be compatible with the existing price control and incentive arrangements, but NGT also believes it should also be consistent with the work being undertaken to develop price controls and incentives for TOs under BETTA.

Ofgem has proposed three types of adjustment mechanism. Our views on these are provided below.

- **Lump sum allowance**

We believe a lump sum approach would be the most appropriate way to proceed in the short term for the reasons outlined below.

We consider there are significant merits with this approach in terms of its compatibility with the existing and proposed framework for price controls and incentives under BETTA and, indeed, the work currently underway to extend NGC's TO price control to the end of 2006/07.

Arrangements of this type are appropriate where there is a reasonable degree of investment certainty. In the context of the initial transmission investments to support the first phase of renewable generation in Scotland, each of the transmission licensees has determined the investments required in their respective networks. NGT has identified a number of specific reinforcements needed for those renewables expected to connect up to 2006/07, which includes upgrades to the Scottish interconnector circuits, the Heysham Ring circuits, the North East Ring circuits and the installation of additional reactive compensation. Therefore, NGT would contend there is sufficient certainty in the investment required to support the use of this type of price control adjustment for the investments we have identified.

This approach, like the main price control, permits the additional allowed revenues to be phased over the time period being considered by Ofgem. Similarly, if this approach were adopted, NGT believes efficient investments should be added to regulatory asset base at the end of the 2006/07 and subsequently funded through the main TO price controls.

- **Revenue driver**

NGT believes revenue drivers may be appropriate to incentivise additional outputs from an existing network or to cater for low levels of uncertainty, but given the uncertainties introduced by the inevitable shortcomings of their implementation in practice, they should not be used as the principal method to fund significant levels of network investment.

The consultation paper discusses revenue drivers that range from the fairly simplistic (like NGC's existing generation connection 'Gt' revenue driver) to more complex arrangements where the driver could vary with location or generation capacity. Across this spectrum, Ofgem has identified complications that arise from each of these. NGT agrees with this analysis and observes that the various shortcomings may be exacerbated given the scale of the revenues and their timing that would need to be derived from the driver.

Furthermore, there are a number of practical issues that would need to be resolved in order to develop an effective revenue driver to fund network investment, not least of all the identification of a suitable output measure to drive revenue in a timely manner. In particular, any output measure would need to recognise that much of the expected renewable generation is likely to be embedded and may be licence exempt, and therefore may not have a contractual relationship with the transmission network owners that incur the investment costs.

- **Cost pass through**

Where there is significant uncertainty in the level of investment required, NGT believes that the benefit of reduced risk and hence financing costs of cost pass through arrangements merits the loss of efficiency incentives. There is also scope

for cost pass through to be combined with other approaches with incentives in a hybrid mechanism, for example, as has been included for the forthcoming DPCR. As noted above, transmission licensees have identified specific schemes which suggests that for the initial investment phase, cost pass through may not be appropriate. However, this may not be the case for later phases of renewable generation. If there is additional uncertainty associated with later stages of transmission investment, the hybrid mechanism that Ofgem has developed for distribution investment (which has a significant element of cost pass through) may become more appropriate, but this could be addressed in the setting of the next transmission price control.

In each case, the cost of capital that Ofgem assumes should be consistent with the risks arising for the investments concerned and the methods used to adjust the price controls.

In summary, NGT believes a lump sum approach would be the most appropriate way to proceed in the short term, as there is sufficient certainty in the reinforcement costs required up to 2006/07. However, to the extent that there still remains a degree of uncertainty in the level of future renewables developments, NGT believes there may be scope for other mechanisms to be developed as part of the next main transmission price control review.

Determining the efficient level of investment

NGT supports the process Ofgem has identified to assess the efficient level of investment for the initial phase of renewable generation. However, in following this process, we believe it is important that the particular circumstances associated with these investments are taken into account. For instance, given the lack of a direct relationship between NGC and developers of renewables in Scotland, and changes to the treatment of the Scottish interconnector under BETTA, NGT must rely upon information from the Scottish transmission companies on the expected level of renewable generation to determine the transmission investment required in England & Wales. In addition, Ofgem must give assurances that such investment is efficiently incurred despite the lack of a contractual relationship between NGC and developers.

The transmission licence requires NGC to plan, develop and operate its transmission system in accordance with the Security and Quality of Supply Standards (SQSS). These contain deterministic criteria as well as economic cost benefit requirements. Where particular circumstances would mean that meeting these standards would not be the most economic approach, a derogation from Ofgem can be sought. In accordance with these standards and our licence obligations, NGT believes the efficient level of investment is that required to meet the security standards including that investment that can be shown to be economic on a cost benefit basis. Where economic justification for investment is required, NGT believes the cost benefit analysis should not only consider constraint costs but should also consider other benefits that may arise, for instance, from reductions in the level of transmission losses or the avoidance of certain asset replacement work.

Contractual and charging arrangements

A large proportion of the issues raised in these areas have already been consulted upon or are currently being consulted upon in other documents and we would welcome clarification from Ofgem as to how the responses to this consultation relates to these and will be taken forward.

As noted by Ofgem, the question as to whether NGC's charging methodologies should be amended to take into account increased levels of renewable generation has already been the subject of previous consultation. NGT remains of the view that any subsidy or support for renewable generation should be made explicitly (for example, through ROCs) rather than modifying NGC's charges to benefit particular classes of users. NGT believes such an approach could be discriminatory and may reduce the cost reflectiveness of the signals provided to developers to make efficient, economic trade-offs between different locations and voltage levels.

The consultation seeks views on the duration and equitable allocation of access rights to existing and future generators. This has been the topic of a number of consultations over the last couple of years, which has revealed very little industry support for the introduction of market-based methods to allocate access rights, given the additional costs that would have to be set against the benefits that might be achieved. The previous discussions have yet to identify a suitable tradable access product or show a clear cost benefit for such arrangements. Furthermore, in the context of renewables, NGT believes such market-based arrangements would give rise to particular complexities and transaction costs for intermittent generators.

Given that large and potentially inefficient constraint costs could arise if firm access rights were allocated prior to the establishment of the new network capacity required, NGT believes an "invest then use" approach is appropriate (as well as necessary to show transmission licensees remain in accordance with their security standards). Improvements to the existing access arrangements are currently being progressed and it is our belief that these should address concerns raised about the existing access arrangements. It is important, therefore, that access developments are co-ordinated across the different current initiatives.

NGT also notes there is considerable overlap in this area with the consultations concerning the delivery and implementation of BETTA where NGC, in its role as GB System Operator designate and at the request of Ofgem / DTI, is currently consulting the industry on the different methodologies for determining the initial allocation of access rights to the GB transmission system. The consultation examines a number of different approaches and sets out the issues associated with these.

We welcome Ofgem's commitment to review the cost signals provided to small generators next year and we look forward to playing a constructive role in this work. We believe users should face charges that reflect the costs they impose on network owners, as this is an important aspect to ensuring the efficient and economic development of the system. However, the issues associated with small generators and exporting GSPs are brought into sharper focus in the advent of BETTA and hence we believe a speedy review is appropriate.

Please contact me if you have any queries regarding our response.

Yours sincerely

By e-mail

Lewis Dale