

Jonas Tornquist
Head of Electricity Transmission Policy
Networks Division
Ofgem
9 Millbank
London SW1P 3GE

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0141 568 2983

Dear Jonas,

**Transmission Investment for Renewable Generation
Second Consultation
May 2004**

Thank you for the opportunity to respond to this consultation. This response is submitted on behalf of ScottishPower UK Division, which includes the UK energy businesses of ScottishPower, namely ScottishPower Energy Management Ltd, ScottishPower Generation Ltd and ScottishPower Energy Retail Ltd.

I hope that you find these comments useful. Should you have any queries on the points raised, please feel free to contact us.

Yours sincerely,

Alex Brennan
Commercial & Regulation Director
ScottishPower Energy Management Limited

**Transmission Investment for Renewable Generation
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Response by ScottishPower UK Division

1 Executive Summary

ScottishPower UK Division (SP) believes it is clear that the Government's firm targets for the percentage of electricity to be generated from renewable energy sources by 2010 and 2015 and its aspirational target for 2020 can only be achieved if the potential renewable energy resources of Scotland are fully exploited. In order to meet these targets it is essential that sufficient transmission capacity is available to facilitate full access to the GB-wide electricity market and in particular that the reinforcements identified under the RETS programme are put in place as soon as possible.

It is essential that a funding mechanism is put in place which incentivises the transmission licensees to make the necessary investments ahead of requirements. This will require the transmission licensees to be able to proceed on the basis of agreed forecasts of capacity requirements knowing that they will be allowed an appropriate return on their investment irrespective of the actual output generating capacity commissioned.

Since it is only necessary at this stage to cover the period up to 2006/07 a simple funding mechanism should be put in place such as a lump sum allowance, similar to the existing price controls, determined from the forecast level of efficient investment, together with the recovery of financing costs i.e. depreciation and return.

It is necessary to recognise that the new renewable generation and consequential infrastructure investment, a large share of which will be in Scotland, are driven by the need to meet a UK target and will benefit GB as a whole. Consequently, the individual price control adjustments should be based on common assumptions as to the investment required across GB, and the overall costs of this investment should be spread evenly across GB as a whole. If BETTA is delayed then a means must be found of recovering the aggregate additional GB costs uniformly across GB users and reallocating this recovered revenue between the transmission licensees.

NGC's currently proposed GB transmission charging methodology places an excessive burden on generators, particularly those in Scotland, that are relatively distantly located from GB centres of demand and introduces tariff instability. These shortcomings will need to be addressed if sufficient renewable generators are to be incentivised to connect to the Scottish system to meet the Government's targets.

The funding of the proposed transmission investment introduces further uncertainty as to the initial and future level of transmission charges under BETTA. It would be beneficial if Ofgem could provide NGC with accurate estimates of the additional revenue to be recovered from GB transmission charges in time for these to be incorporated into the indicative tariffs on which NGC will consult in September 2004.

It would not be appropriate to delay capacity provision until constraint costs exceed investment costs. This would send the wrong message to renewables developers and would act as a further disincentive to achieving the Government's renewable targets.

2 Response to Specific Views sought by Ofgem

a) Revenue deriving from the adjustment mechanism

We agree that the revenue deriving from the adjustment mechanism should be based on the funding costs of projections of investment over the period 2004/05 to 2006/07 and welcome the use of a co-ordinated approach to looking at all 3 networks together rather than separately, and also addressing the potential for double counting. We agree that Ofgem's consultants should co-ordinate and review the assumptions used by the three transmission licensees regarding the future developments of their respective networks. This analysis should supersede the TIWG report, particularly given that the latter may have overstated the requirements through the inclusion of the 1320 MW Norwegian link.

b) Identification of outputs

We do not consider that this is an issue that requires to be resolved at this stage. It is important that transmission licensees are incentivised now to instigate the initial development work, which is likely to involve seeking planning consents. Licensees should not be allowed returns on investments that are not fit for purpose and it will be appropriate to develop suitable outputs to measure this. We believe, however, that this could be undertaken as part of the next main price control review to be put in place from 2007/08 onwards.

c) Dealing with planning uncertainties

Accommodation of additional renewable generation is likely to require the construction of new overhead line routes with long lead times for obtaining planning consents. Any delays which are due to the obtaining of planning consents could be addressed by deferring addition to the RAB until consent is obtained. This would provide an incentive for transmission licensees to mitigate potential delays, without creating undue further uncertainty.

d) Cost of capital

In order to ensure that transmission licensees have the necessary incentive to invest we believe that it will be necessary for the cost of capital for the period up to March 2007 to be the same as that used in setting the main price control. Provided the stranded investment risk is removed with licensees guaranteed an appropriate return then we do not believe there is a need for a higher cost of capital than that allowed on the rest of the licensees' RABs.

e) Identification of annual revenue drivers

We do not think it will be possible to identify suitable simplistic revenue drivers in the short term for the likely necessary investments in Scotland. Reinforcements in Scotland are likely to be triggered by the connection of generation over a larger range of voltages than is the case in England & Wales and are likely to require the construction of new overhead line routes. Again we do not believe that this issue needs to be resolved at this stage and could be addressed as part of the next transmission price control review.

f) Renewable generation in Scotland

We agree that at present there is significant uncertainty about the level of renewable developments in Scotland and believe that this uncertainty is likely to continue for a number of years. Nevertheless it will be necessary to come to an agreed level of transmission reinforcement which will require funding in the short term. Assessing the economics of renewable energy development in Scotland is complicated by the uncertainties in the transmission charges to be faced by generators under the currently proposed GB transmission charging methodologies. As evidenced by the responses to NGC's recent GB Transmission Charging Initial Methodologies consultation, the level and temporal stability of these charges are key issues for such investment decisions. Indeed these issues may form a barrier to new entrants by affecting their ability to obtain finance, such that the chosen GB charging methodologies will be a key determinant in whether sufficient growth in renewables in Scotland is achieved, consistent with UK targets for renewable generation.

g) Operation of existing conventional plant in Scotland

In the timescales considered in this consultation, i.e. up to 2006/07, we believe it is clear that the assumption that should be made about the operation of conventional plant in Scotland is that such existing plant continues to have full firm access to the GB network. Any other assumption would be contrary to statements made by the Government and Ofgem in the lead up to BETTA.

h) Economic assessment of transmission upgrades

While it is clearly desirable in the long term to achieve an optimal balance between the cost of transmission system reinforcement and the cost of making constraint payments in lieu of such network reinforcements, we do not believe it is appropriate at this stage to delay capacity provision until constraint costs exceed investment costs. This would send the wrong message to renewables developers and would act as a further disincentive to achieving the Government's renewable targets.

i) Expected costs of reinforcement schemes

We agree that Ofgem consultants should co-ordinate and review the assumptions used by the three transmission licensees regarding the costs of future developments of their respective networks. At this stage, however, the work undertaken by the transmission licensees on the RETS programme should be sufficient to cover the period up to 2006/07.

j) Appropriate changes to NGC's charging methods

NGC's currently proposed GB transmission charging methodology places an excessive burden on generators, particularly those in Scotland, that are relatively distantly located from GB centres of demand and introduces tariff instability. These shortcomings will need to be addressed if sufficient renewable generators are to be incentivised to connect to the Scottish system to meet the Government's targets.

k) Commitment by generators to long term access arrangements

We do not believe that generators who trigger significant investment in the transmission system should be required to commit to longer-term access arrangements. Investment in

infrastructure is not generally attributable to a single generator and is seldom attributable even to a small set of generators. To the extent that reinforcements will provide a more robust and secure transmission network, the reinforcements required for RETS will be of benefit to a large number of GB network users.

l) Allocation of access rights to generators

We believe that access rights should continue to be allocated on a first come, first served basis.

m) Trading of transmission access rights

Separate consultations are underway on the trading of Transmission Entry Capacity within a GSP and while this could be difficult to manage there may very well be some locations at which such arrangements could work. This issue does not need to be resolved in identifying the investment required up to 2006/07 and should not delay Ofgem's decision on this consultation.

n) Appropriate contribution from distribution connected generators

This is also an issue on which separate consultations are underway and which we do not believe needs to be resolved in the short term. In determining appropriate contributions from embedded generators it is important to recognise that flows onto the transmission network can be caused by reductions in demand as well as by increases in output from distribution connected generators.