SP TRANSMISSION

RESPONSE TO OFGEM'S SECOND CONSULTATION ON TRANSMISSION INVESTMENT FOR RENEWABLE GENERATION, MAY 2004

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1. Introduction

SP Transmission (SPTL) welcomes this consultation on transmission investment for renewable generation. Interest in connecting renewable generation, particularly onshore windfarms, continues to increase. As confirmed in the consultation paper, there is now nearly 11GW of generation at various stages in the connection process in Scotland and, consequently, SPTL agrees that this issue needs to be addressed now rather than wait until the full transmission price control reviews.

2. The October consultation - respondents' views

We note from paragraph 3.8 that one respondent to the October paper commented that the aggregate investment cost is estimated to be around £250/kW which was purported to be over ten times the investment costs assumed for additional capacity in NGC's current price control. In order to avoid any misunderstandings we think this needs to be clarified. The Gt term (£23/kW) in NGC's price control formula is an annual revenue adjustment to provide an allowance for return and depreciation on unanticipated investment within a price control period. The £250/kW is simply the total investment cost divided by the projected kW of renewable generation. (£520m [1] divided by 2GW.) The two values cannot be compared directly.

3 Adjusting the price controls

3.1 An adjustment mechanism

SPTL notes that, at this stage, Ofgem proposes to address the funding of transmission investment to accommodate renewable generation between 2004/05 and 2006/07 using an additional mechanism alongside the existing price control. The development of the funding mechanism should not be disproportionate to the benefits, both for SPTL and users, which could be achieved over that short term. Further analysis and development, if appropriate, could then take place prior to the next main price control reviews, which are now due for implementation in 2007/08.

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[1] £190m for SHETL, £160m for SPTL and £170m for NGC.

3.2 A lump sum allowance

SPTL believes that a lump sum allowance, similar to existing price controls, would provide the necessary incentives to invest efficiently and without unnecessary delay, and would best meet the needs of government and the renewables community. This should be determined from the forecast level of efficient investment, together with the recovery of financing costs (ie depreciation and return).

At the next main price control review, this investment should be added to the regulatory asset base (RAB). However, in view of the short period remaining and to avoid periodicity effects, efficiency gains should be retained for a fixed period of time, irrespective of the year in which they arise. To ensure that incentives for efficiency are maintained, both the return and depreciation components should be retained for this fixed period.

As Ofgem recognises, this approach maintains the high incentives for capex efficiency. If appropriate, further consideration could be given to the measurement of outputs or the development of appropriate revenue drivers, as part of the main price control reviews. SPTL believes that it would be disproportionate and impractical to introduce these prior to April 2007.

3.3 Revenue driver

SPTL notes that NGC currently has an adjustment factor of £23/kW of new generation connected to the transmission system to provide additional revenue for unanticipated infrastructure reinforcements. Our view is that this would not be appropriate for renewables in Scotland for the following reasons:

- Accommodation of additional renewable generation is likely to require the construction of new overhead line routes. This will entail long lead times between planning applications and the connection of the generators. Additional revenue may be required well in advance of the connection being commissioned, and consequently, the time of qualification for a revenue adjustment;
- Agreement of a fixed correction factor for each additional kW is likely to prove too problematic in the time available. This is partly due to reinforcement being triggered by the connection of generation over a larger range of voltages (33kV to 275kV) than is experienced in England & Wales; and

- Investment to cater for distribution connected generation would need to be assessed separately in terms of its impact on investment costs.

3.4 Related issues

Any short delays, within the period to March 2007, encountered through obtaining planning consents should be ignored. However, delays extending into the next main price control period could be addressed through the roll forward of the RAB, at the next main price control review. This would provide an incentive for companies to mitigate potential delays, without creating undue further uncertainty.

The cost of capital, for use up to March 2007, should be at least that used in setting SPTL's main price control. Nevertheless, should the transmission licensees have additional risks imposed upon them, then it would result in an increase in the cost of capital. However, SPTL does not believe that it would be in customers' interests to increase the risk exposure of SPTL.

4. Determining the efficient level of investment

It is clearly desirable 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. However, the consultation paper tends to focus on the economic tests for reinforcement. The trade-off between ongoing balancing costs and investment costs is not the main factor in consideration of investment decisions. Transmission licensees must have due regard to system security, planning standards and operating standards.

In considering these standards we must also take account of the inability of wind generation to provide reliable voltage and frequency control. A certain amount of conventional generation will still require to be connected to the network to ensure reliable and secure operation. Therefore, at times of low demand coinciding with high wind, wind generation may need to be constrained back to enable system operations.

These issues are well known and will no doubt be considered by Ofgem's independent consultants when evaluating our transmission reinforcement proposals.

5. Contractual and charging arrangements

5.1 Changes to NGC's charging methodology

The paper asks for views on what changes, if necessary, might be appropriate to NGC's charging methodologies to take account of renewable generation. This issue has already been covered in

the Ofgem/DTI consultation on smaller generation under BETTA and in the NGC GB charging consultation. We therefore do not wish to add anything in this consultation.

5.2 Commitment to longer-term access arrangements

We are aware that Ofgem has consulted on this issue in England and Wales and that an entry capacity investment incentive scheme has been introduced for Transco at certain entry terminals. SPTL believes that there may be potential for a scheme whereby users can indicate their longer-term needs for the network and, in doing so provide efficient investment signals. However, the circumstances need to be right.

The reason that the gas investment incentive scheme could be introduced was that the constraints occurred at the beach point. In that instance users were very clear on the exact commodity which they were purchasing– the right to ship gas through the terminal. Even so, the gas regime is as yet unproven.

The reason it had to be introduced was that there had been underinvestment in gas capacity. We are not aware that there has been underinvestment in electricity infrastructure. Indeed, after the South London and East Birmingham transmission failures in 2003 Ofgem advised that there had been high levels of investment in reinforcing the transmission system in England & Wales - £3bn since privatisation. There is no reluctance on the part of the transmission licensees to invest in the network to meet users' and government objectives.

There are key differences in gas and electricity constraints. Electricity constraints do not manifest themselves at entry points, as in the case of gas, but at bottlenecks deep within the network, remote from the generation connections. We believe that generators would be disinclined to commit themselves in the longer term for the purchase of access rights across remote constraints.

Furthermore, investment in infrastructure is not generally attributable to a single generator and is seldom attributable even to a small set of generators. The reinforcements required for RETS will be of benefit to all existing and new generation in Scotland.

Finally, the purchase of access rights seems to be at odds with recent developments in connection charging methodology in England & Wales where a shallow connection policy has been amended to be ultra-shallow. Asking users to pay for long-term access rights may be interpreted as deep connection charging under another name.

5.3 Allocation of access rights

Our view is that access rights should continue to be allocated on a first come, first served basis. We believe that existing customers should have priority over any new customers.

System access rights should be contingent on the delivery of certain Grid Code performance criteria, which are critical for network security, such as the capability to ride through faults.

5.4 Tradable entry and exit rights

We are aware that NGC has proposed an amendment to the CUSC to allow trading of Transmission Entry Capacity. It is difficult to see how this could be managed across Scotland. There may be some locations at which these arrangements could work at times of extended plant outages but it is difficult to envisage any other circumstances.

As for exit rights we do not believe that there is the demand for a market in exit rights. We cannot see the problem that this is trying to resolve.

5.5 Charges on distribution connected generation

The issue of charging embedded generation is a difficult one. Exports can occur at a bulk supply point if demand reduces and/or if generation increases. It will no doubt lead to disputes if a generator, with whom the transmission company has no contractual arrangements, is charged for transmission use of system charges.