

≡ Scottish and Southern Energy plc

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Dear Jonas,

Consultation on Transmission Investment for Renewable Generation

I have set out below SSE's comments on the above consultation. If you need any further information or clarification, please give myself or Dave Densley (01738 456407) a call.

Yours sincerely,

Rob McDonald
Director of Regulation

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Response to Ofgem Consultation on Transmission Investment for Renewable Generation

Summary

We believe that a lump sum adjustment to allowable revenues should be allowed for RETS funding. This should be on the basis of a 20-year investment life, with a cost of capital set to reflect the additional risk of these substantial investments over the normal price control expenditure.

Where investment is delayed by public enquiry or other substantive delays in obtaining approval, the licensee should not be allowed to benefit inappropriately from such delays. We believe that this can be dealt with by a letter of intent from Ofgem which sets out clearly that any benefit from advanced funding will be returned to customers in such circumstances.

The conventional economic test for transmission investment is on the basis assessing the expected difference between the costs of constraints with and without the investment against the annualised cost of investment. This test works well for single large conventional plant but is problematic for diverse renewable generation. While there will still be a role for this test to play in the future, where there is a clear technical limitation we believe the obligation is on the licensee is to carry out the infrastructure work and connect the generator.

Adjustment Mechanism

We agree with Ofgem that it would not be appropriate to reopen the price control and that an adjustment mechanism should be used. Ofgem have identified three options for such a mechanism, which are discussed below.

Revenue Drivers

These can be an appropriate mechanism for incremental capacity requirements. However, the level of investment required in SSE's area is an order of magnitude more than the amount currently spent for incremental growth and asset replacement. We do not believe an efficient revenue driver mechanism could be designed to deliver the funding required for such a project. It is also clear that this would involve a substantial amount of work and hence this approach is not consistent with the investment timetable.

Cost Pass Through

We do not agree with the suggestion that cost pass through necessarily provides no incentives for the licensee to deliver efficient investments. Ofgem have provided no evidence to support this assertion. It is also important to note that cost pass through is very flexible in accommodating varying amounts of capacity, and this option should not be ruled out given the uncertainty of the level of generation.

Lump Sum

The lump sum approach is the traditional price control mechanism, and has proved to work well in the past. We would therefore support this approach as providing the correct balance of incentives to deliver the capacity.

Dealing with Planning Issues

Ofgem have invited views on an appropriate mechanism to deal with the uncertainties created by the requirements on licensees to obtain planning consents.

For many projects there is a risk regarding the timing of investment, in that the licensee's ability to construct the capacity is constrained by external factors such as wayleaves and planning consents. Even though a licensee may have the capability, the incentive and the willingness to deliver the capital investment, these external factors could delay its delivery. However, once these hurdles are cleared, the project should in principle be capable of progressing according to the phasing of costs identified by the licensee.

Against this background, we accept that the licensee should not be allowed to benefit inappropriately from substantial delay in the project. The key risk in this regard is a lengthy public enquiry, or another substantive delay in obtaining planning approval. We therefore believe that Ofgem should focus on solutions to this issue, rather than the detailed phasing of the project, otherwise the arrangements risk mimicking cost pass through with all of the perceived problems noted by Ofgem.

We believe that the simplest solution would be a letter of intent from Ofgem which sets out clearly that any benefit from advanced funding will be returned to customers in the event of a public enquiry or any substantive delay in obtaining planning approval. This adjustment could either be made at the next price control review or, if necessary, mid price control (although the latter approach could be difficult mid-year).

Funding Issues

It is essential that transmission licensees are provided with sufficient incentive to undertake such substantial investment in infrastructure. We do not believe that a 6.5% (pre tax) cost of capital is sufficient or reflects the risks of such an investment.

We also believe that the depreciation period for the relevant assets should match the economic life of the generation projects that are driving the investment of 15-20 years. Without this there is a risk, either of stranded investment if the generation subsequently closes or of the residual costs being funded by the remaining transmission users. In addition, we do not believe that shareholders would be willing to fund investment over a longer period.

The Efficient Level of Investment

As a general point, transmission licensees have to comply with their licence standards for security and quality of supply. Some of these set absolute technical limits, which cannot be exceeded, whereas others stipulate an economic test. Where the investment

is subject to an economic test, transmission licensees have hitherto assessed the expected difference in the annual costs between constraining with and without the upgrade against the annual costs of the upgrade. We firmly believe that the Beauly-Denny project would pass such a test.

More generally, however, we do not believe that the application of the same test as would be applied for example to a new CCGT is appropriate in the case of diverse development of renewable generation. In particular, we believe that where there is a technical limit, then clearly the investment needs to be made irrespective of the strict economic test applied hitherto to large conventional generation.

A simple example is a 500 MW generator wishing to connect at the end of a line with only 100 MW firm capacity. The line would need to be upgraded to comply with the technical limits, and this cost would be charged to infrastructure. The “economic” test would not be appropriate in this case since the only generator it is possible to constrain would be the one wishing to connect. We believe that the licensee’s obligation to ensure that the technical limitations of the system are not exceeded is the overriding requirement, and it is the generator’s decision where to locate.

Contractual Arrangements

Ofgem have requested views on a number of issues relating to contractual and charging arrangements in the longer term. However, anything that creates further uncertainty for generators wishing to connect to the system can only be counter productive. BETTA has been promoted on the basis of extending the E&W contractual framework access arrangements and charging principles into Scotland. Many generators have already taken investment decisions and obtained project finance on this assumption. It is vital that further reforms of transmission access and pricing do not undermine these investments.

Against this background, we have set out our comments below on each of the areas noted in the paper.

- Changes to NGC charging methodology. NGC have not yet finalised their proposals for implementing their existing charging methodology into Scotland. We believe that the locational charges in their current model are extreme and reducing the impact of the locational element would mean that the DTI would not have to introduce additional subsidies for renewable generation in the peripheral areas.
- NGC have previously consulted on a proposal for long term access arrangements, and this was not widely supported. In particular, this would run counter to the principle of shallow charging which is designed to reduce barriers to connection. Long term commitments would be tantamount to a deep connection charge.
- Access rights have always been allocated on a first come first served basis, and we agree that there should be a more equitable way of managing the queue for connections so that there is no perverse incentive to hoard capacity.
- NGC are already developing the arrangements in E&W so that TEC can be transferred or traded. We do not believe any additional provisions would be required.

- The Government's targets for renewable generation have caused an unprecedented level of connection applications from generators in Scotland. Many will connect to the distribution network, and Ofgem have recently introduced proposals to incentivise distribution licensees to encourage connection of distributed generation, including shallower connection charging, Registered Power Zones and the Innovations Funding Initiative. This, coupled with NGC's charging principle that embedded generation does not pay TNUOS charges, is encouraging generators to connect to the distribution system in Scotland. As noted above, BETTA has been promoted on the basis of the existing E&W suite of contracts. It would in our view be unacceptable to revise these charging arrangements at this late stage of the project.