

Mr Jonas Törnquist
Head of Electricity Transmission Policy
Networks Division
Ofgem
9 Millbank
LONDON SW1P 3GE

telephone : 01851 703773 Ext 270
e-mail : dmckim@cne-siar.gov.uk
fax : 01851 706022
writer : Derek McKim
our reference : DMKL3901
your reference :
date : 24 September 2004

Dear Mr. Tornquist,

TRANSMISSION INVESTMENT FOR RENEWABLE GENERATION : INITIAL PROPOSALS

Thank you for the opportunity to respond to the above consultation.

The Western Isles plays host to a sizeable potential for wind, wave and tidal-based renewable technologies. Comhairle nan Eilean Siar took the initiative in 2001 to set out a vision of the Western Isles as an Energy Innovation Zone and is aiming at the realisation of an integrated investment strategy. This strategy has been developed closely with our Community Planning Partners and renewable energy has been recognised as the Key Driver in our recently adopted partnership framework **'Creating Communities of the Future'**.

Clearly we would see the Western Isles as being in a position to make a significant contribution to the achievement of the Scottish and UK targets, coming from the Kyoto agreements, for renewable generation to provide 10% of UK electricity by 2010 with a further aspiration to double this share by 2020. We would concur with the general expectation that a significant proportion of this renewable generation will be wind sourced in the first instance and located in Scotland. In the Western Isles alone we expect that firm applications for 3 major on-shore wind farms with a total output of over 1.1 GW will be submitted to the Scottish Executive before the end of this year and we would see this as just being the start, with the further opportunities coming in due course from the new marine technologies which are now being developed, for example, using the European Marine Test Centre in Orkney. In addition we are also actively looking at the use of hydrogen-based technologies for both storage and transmission of renewable generated energy. We, therefore, fully expect that renewables should allow the economy of the Western Isles to undergo a very welcome step change.

It is, of course, readily apparent that these major developments can only take place provided the necessary investment is made to the transmission and distribution infrastructure. With respect to the Western Isles this would necessitate significant investment both in the grid connections between the Islands and the mainland and to the mainland grid itself. The Government at both UK and Scottish levels is promoting renewables for both environmental and social objectives and it would be a perverse outcome if the areas such as the Western Isles which have the both the best energy potential and the most fragile economies and which, therefore, have the most to gain from renewable activity were prevented from doing so by the adoption of inappropriate investment policies. The Comhairle is concerned that delay will give rise to uncertainty in the renewables industry leading to a real danger that the 2010 and 2020 targets will not be achieved given the importance for those targets which should be accorded to the proposed developments for our area.

The Comhairle has responded to the recent NGT Transmission Charging Final Methodologies Consultation indicating disappointment that the opportunity has not yet been taken to facilitate the achievement of the Government's targets via the recommendation of a transmission charging regime which would assist the development of the potential for renewables in those areas with the greatest resource, including the Western Isles. Indeed the consultation is silent on generation in the Islands and this can only lead to uncertainty and a consequent lack of confidence amongst prospective developers and investors. Furthermore, in a response to the Scottish Parliament earlier this year the Comhairle indicated that it was not in agreement with the Ofgem philosophy of "cost reflective charging" on the basis that this would restrict the development of the renewables industry unnecessarily and, in turn, would make it less easy to achieve the Government's targets. This argument was reiterated in a letter to the then Minister of State, Stephen Timms MP, on behalf of the Scottish Islands in July this year. In that letter we illustrated the gravity of our concerns by highlighting the estimate for a fully cost reflective equivalent charge for a 300 MW project in the Islands at over three times the cost to a mainland North of Scotland generator. The use of such levels of charging for use of transmission systems can be demonstrated by modelling as to render most proposals for the Islands unviable and this has been confirmed by discussions with major developers. In response the Minister outlined the consultation process for transmission charges and also the potential power in the Energy Act to allow the Government to adjust these charges for renewable on a temporary basis.

Turning to the current Ofgem initial proposals the Comhairle notes the background to the proposals including the statutory and legislative framework within which Ofgem and the transmission licensees operate. However, we have concerns about the relatively short time horizon employed. In our view the concentration on proposals for funding transmission investment in the period before the next transmission price controls is too restrictive and will inevitably lead to a reduction of confidence in the industry. This is compounded by the references to the 2010 and 2020 targets.

One way to alleviate this perceived difficulty would be to distinguish between investment for design and engineering and that for actual construction and for a different mechanism of regulatory sanction to be used in each case. Indeed this could be taken even further and consideration be given to more innovative funding mechanisms to be used for the relatively small investments required for design and engineering works, as opposed to construction works.

The proposals document rests heavily on the evaluation by SKM of proposals put forward by the licensees. In general the figures relating to the Western Isles accord with our own information. However, we have concerns about the outcome and the conclusions drawn both by SKM and Ofgem on the basis of the submitted information as being somewhat artificial. The distinction between the categories of baseline investment and incremental investment is accepted but the third category of additional investment is seen as being rather too coarse grained and simplistic to stand serious scrutiny. However, although understanding that there are differences between the first two categories and the third in terms of an ability to quantify and evaluate outcomes there is the serious concern that the methodology will give rise to even more uncertainty and lack of confidence amongst developers and investors. A more refined categorisation would be preferred perhaps allied to a differentiation between initial design and engineering works and construction works as suggested above. This would then allow a more acceptable classification than the one employed based in part on the spurious quantification of capital to investment costs where these are not known. In general we would accept the incentives proposed for each category with the proviso about the third category requiring refinement as outlined above.

In terms of the classification so far as it affects the Western Isles I am pleased to see the Beaulieu-Denny Upgrade has been seen as a justified baseline investment project. As suggested above a mechanism needs to be found whereby the design and initial engineering works for Beaulieu-Islands links can be allowed to proceed with due haste and be followed by approval for the actual construction on the basis of firm demand. Our information would indicate that the Beaulieu-Keith reinforcement is not “well ahead of need”. I would welcome dialogue on this. I will be making some separate detailed comments on the SKM report.

Finally, I would welcome the opportunity to meet with you to discuss your initial proposals and the contents of this letter, either bilaterally or together with the other Scottish Islands. I look forward to hearing from you.

Yours sincerely

Derek McKim
Head of Strategy (External)