

**dti**

---

RECEIVED  
28 APR 2006

Bob Hull  
Director, Transmission  
Ofgem  
9 Millbank  
London SW1P 3GE

26 April 2006

Department of Trade and Industry

Energy Group

Bay 112  
1 Victoria Street  
London  
SW1H 0ET

Tel +44 (0)20 7215 2653

Fax

Enquiries +44 (0)20 7215 5000

Minicom +44 (0)20 7215 6740

[www.dti.gov.uk](http://www.dti.gov.uk)

[Kristian.Armstrong@dti.gsi.gov.uk](mailto:Kristian.Armstrong@dti.gsi.gov.uk)  
v.uk

Dear Bob

### Transmission Price Control Review

Thank you for taking the time to present your thinking on the Transmission Price Control Review to us recently. We have now had time to digest what was an extremely interesting and helpful presentation together with your latest consultation document. I have set down our thoughts below in relation to its impact on renewable generators and the achievement of government's targets in this area.

#### Price Control & Incentives

The concept of a revenue driver related to level of generation connected seems very attractive. However, we believe that the £/ MW connected figures will need to be sufficiently locational to reflect the wide range of costs associated with connecting generation across the UK and pitched at a level that gives a real financial incentive to connect generation. With these two provisos what you are proposing should produce a helpful environment for developers wishing to connect to the system. Being allowed to keep the difference if they can connect generation for less than the £/MW figures agreed, should also encourage National Grid to innovate and adopt cost-efficient solutions. A potential downside could be that a pure £/MW approach could drive National Grid to go for the easy and cheap connections to the detriment of more expensive schemes. Ofgem's recognition that a "TIRG" option would need to be retained to deal with difficult but strategic investments is therefore helpful.

#### Constraint Payments

Moving on to consider how constraint payments may impact on the above approach. Currently, it can be argued that National Grid is overly

## Continuation 2

incentivised to invest in assets rather than optimise overall capital and operational spend. In an environment where individual generation projects are smaller, more numerous and less certain than in the past, we think greater emphasis should be placed on finding operational measures to reduce the risks of new assets being stranded. However, even if a price control could be designed that incentivised overall spend, it is not clear that National Grid could make objective decisions about whether to invest or rely on operational measures, as they are exposed to constraint costs which potentially include over-recovery by conventional generators.

Your recent consultation addresses this issue and suggests the use of TIRG-type constraint cost values in justifying capex requirements via cost benefit analysis and as the basis of revenue drivers and incentives. We would certainly support this approach, but would have some concerns about National Grid being incentivised on the basis of TIRG-type constraint costs while being exposed to actual constraint costs which might include an element of over-recovery. Given that the whole point of deploying renewable generation is as much to replace the output, rather than simply the capacity, of conventional fossil-fired generation, one wonders whether the current arrangements for dealing with constraints will be appropriate in the future, or whether a cost-based approach would be justified

Finally on this issue, we think it would be helpful if the SQSS were brought into line with cost benefit analysis using prescribed constraint cost values as quickly as possible, in order to avoid complications in justifying transmission reinforcements at Public Enquiries etc.

### Transmission Access

The adoption of gas market-type exit arrangements and a more equitable sharing of risk between new connectees and the end user is attractive, although much will depend on how the risks are apportioned and what commitments developers are required to make. While recognising that projects must be speculative to a degree before consents and financial closure have been achieved, it will be important to ensure, if at all possible, that developers are able to apply for connection in advance of obtaining consents as understanding the network requirements is often an integral part of the consents process. Early application will also give the Transmission Owners earlier signals of the need for transmission investment.

The concept of specifying a defined period between a developer signing an application offer and becoming entitled to system access is extremely attractive. This would provide developers with real certainty and overcome the present difficulties with connection timescale exceeding planning consent duration. I can see how this might cause National Grid some difficulties in the event of a contentious transmission development and how they might need help in dealing with risks that are beyond their control. However, not all infrastructure reinforcement involves the construction of new overhead line routes. Having to connect generation or buy back access rights within three years would also require National Grid

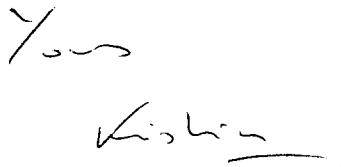
Continuation 3

to move from what appears to be a highly risk-averse approach to project planning which is not helping the current final sums difficulties. Having a strong incentive on National Grid to connect generation as soon as possible would clearly be very helpful.

Overall, the approach you are taking to discharging what is clearly a very major task seems very positive and has our support. However the devil will be in the detail and the effectiveness of the Price Control incentives you described will obviously be dependent on the figures eventually decided upon. I think it would be very helpful if we could instigate regular meetings to discuss your thinking on the Price Control as it progresses – say bi-monthly. We are also open to suggestions as to what we and/or the Renewables Advisory Board can do to help facilitate things across the renewables sector as appropriate. I know that Jim Campbell is also very keen to run through progress at his meetings with David Gray. I will ask my secretary to set these up.

I also note the recent National Grid consultation on transmission access and FSLs. I am encouraged by the increased flexibility that they also appear to be showing and the prospect of introducing transitional changes to existing final sums arrangements in advance of the Price Control outcome, which would clearly be very helpful. I am sure that this reflects Ofgem's leadership in these areas.

Thank you again for taking the time for presenting your latest thoughts to us.

A handwritten signature in black ink, appearing to read 'Kristian', with a horizontal line underneath.

**Kristian Armstrong**  
Director, Renewable Energy Policy and Deployment