CONTRIBUTION

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TO

OFGEM CONSULTATION DOCUMENT

'A Framework for considering reforms to how generators gain access to the GB electricity transmission system

Following a report by the Access Reform Options Development Group (ARODG)

7.6.2006

THE ISSUES – as outlined by the document

- Risk of stranded assets – leading to needless expenditure by Transmission Operators, thus passed on to electricity consumers.
- Balance between risk and security
- Lack of a transparent and predictable picture for investors in generation development (in particular onshore wind)
- Reduced competition due to very difficult market entry
- Perception that parties may apply speculatively for connection
- New entrants treated differently to existing generators
- Generating capacities, on commissioning (CEC) and eventual right to full Network access (TEC). Rights and responsibilities.
- Climate for consents – both- in relation to those for generators and for network reinforcement.

Not included in the report – but worth considering:

- The need to address HM Government's policies and targets on CO2 reduction in relation to climate change.
- Measures leading to positive/negative investment signals in respect of remote regions of the UK with very high 'reserves' of renewable energy.

Brief Discussion of the 'Status Quo' – current grid access arrangements

The report describes the current arrangements (since BETTA start-up) as providing:

a) Strong disincentives (on the face of it) for developers to trigger the building of stranded assets. 100% of security (in 6 monthly increments) is put up by potential developers from the day a connection offer is signed – Final Sums Liability (FSL).
b) Uncertainty and lack of transparency in the eventual level of Final Sums Liability. Due to parties dropping out/coming in on shared reinforcements. FSL s are 'High and Volatile'.

c) The issues of consents for generators and for grid reinforcement exacerbate the uncertainty.
d) Very significant barriers to entry thus competition is reduced.
e) Transmission operators have low incentives to connect generators on time.
f) New users are treated differently (much less favourably) to existing users.
g) Lack of flexibility in TEC – limited 'products' available.

FSOL agrees with these findings of the ARODG

In addition the ARODG noted that:

h) There is incentive to speculatively apply (Table – page 41)

FSOL cannot agree with this finding. In the first instance applicants may be tempted to speculate – and gain an early place in the queue – but this is very soon removed as 6-monthly demands in respect of FSL very soon removes any such incentive to speculate. Perhaps some parties in a 'network rich' area – who are looking at relatively low FSL curves may have some incentive, though it is our belief that this is likely to be the exception rather than the rule.

ARODG did not make comment upon:

- The effect on investment in development of generation in remote – energy rich - areas
- Effect of the status quo in relation to the UK targets for CO2 reduction and target for energy from renewable sources.

It may be that such considerations were outside the remit of the study group. Nevertheless it is our opinion that access to the grid by developers of renewable generation is of paramount importance – if the CO2 and 'renewable' targets are to be achieved.
The effect of the high and volatile FSLs – in the present arrangements – remain a very strong disincentive to investment in renewable generation in remote, energy rich, areas.
The effect of the discussed 'Options' on these factors will also be explored in this contribution.

FSOL remarks on the present system – 'Status Quo'

The present access arrangements seek to strike a balance between minimising the risks of stranded assets v encouragement of generators to invest.
It is the opinion of FSOL that, under the present system, the balance is skewed very much in favour of the former against the latter. This is especially true for remote mainland and Island developments.
The current arrangements are thus prejudicial to the development of large scale renewable energy generation and export from such areas.
The present system of FSL magnifies problems with obtaining consents – in particular- delays inherent in the current planning process, whether these are for generating plant or grid reinforcement.

‘CONSTRUCTING THE OPTIONS’

The ARODG report outlined, then, discussed several options to take forward.
These include (numbering in the original document not followed):

1) Status Quo
2) ‘Date Stamping’ of FSL
3) ‘Date Stamping – with variants
4) ‘Local’ FSL
5) Fixed sum
6) Fixed sum and profile
7) ‘Local’ FSL plus fixed sum

All the above relate to securities

2) ‘Date Stamping’

This is described as setting out an ‘S’ curve of costs, to the applicant, which will not vary after an offer is signed.

Advantages

This seems to meet the issue (b) above in that it would remove uncertainty to the developer where others dropped out.

Drawbacks

There may be a temptation by TOs to reduce their exposure by adding high levels of contingency to the ‘date stamped’ FSL.

Remarks

‘Date Stamping’ on a fair and transparent basis should be the starting point of any of the proposed changes. This would, at least, allow investors in development to properly assess the risk.
The cost to the consumer – though real – is likely to be minimal. The extra risk of stranded assets would also be minimal.

3) ‘Date Stamping’ -Variant

Date Stamped FSL but reduced by a factor – thus TOs (passed on to the consumer) share the risk with the applicant.

If the reduction factor is significant enough – say 50% - then many more of the issues could be addressed. Factors a, b, d and e are clearly met and c, partially.
There would be incentive on both sides to ensure that developments are connected.

4) ‘Local’ FSL only

This is described as applying FSL to the local reinforcement (local works) only – as H1 sole and some shared works.

Advantages

This would be advantageous to those new entrants who had relatively limited H1 works.
This would also take out much of the uncertainty involved in calculating for drop-outs using shared 'deeper' reinforcement.
It is likely to see a reduction in FSLs for most entrants.

Drawbacks

The effectiveness of this measure, as a mitigating factor for parties experiencing problems with the present system, would depend upon the definition (possibly case-by-case) of local works. Since these works are still likely to contain some shared assets – some of the uncertainty regarding drop-outs may remain.
In the case of remote and Island areas this measure is likely to be of marginal benefit at best. In Orkney, for instance, such a measure may only reduce the 'full' FSL by around 25%.

5) Fixed Sum

This is described as an up-front cost, or application fee.

Models for the calculation of such a sum include a multiple of TNUoS (as applicable at the time) a factor of x 5 is used as the example. It is assumed that this cost would be a 'deposit' against a minimum of x years TNUoS payments rather than any extra cost. More details about how partial refunds may be made etc should be made known. In the case of it being seen as an application fee – clarification would be required on its being refunded in the case of eventual connection and use of the Transmission system.

Advantages

A fixed sum would remove uncertainty in regard to final payments – if no other securities were used alongside this.
It would reduce applications made on a speculative basis
The TO would be under greater pressure to complete the works

Drawbacks

The sum of, say, 5 times annual TNUoS – on application – would be a significant barrier to entry and could reduce competition.
It takes no account of when consents may be given to the developer or the TO (in the case of the 'fee' being payable on application for access.

6) Fixed sum and profile

Variant of Fixed sum with starting profile of cost based FSL (date stamped?).

Under this scenario the entrant would begin by paying securities toward a cost based FSL (much as the 'date stamped' model) but this would be 'capped' at the fixed sum level once this figure had been reached on the 'curve'.

Advantages

This would have all the advantages of the fixed sum model – but would reduce the barrier significantly for new entrants, thus aiding competition.

Drawbacks

A significant level of unsecured risk would move to the TO – hence consumer.

7) 'Local' FSL plus fixed sum

This is described as a variant of the 'Fixed Sum' model –and possibly a hybrid also with 'Local FSL'. The model seems to show fixed sum payable on acceptance of offer plus a profile element of 'local' FSL

This model would seem to be less generous to the developer than either of Local FSL or Fixed Sums.

Advantages

Offers some degree of certainty with regard to levels of FSL and securities. Where local reinforcement is limited the overall level of FSL is likely to be lower than standard or 'date stamped' full FSL.

Drawbacks

Very high entry level is fixed sum is demanded on acceptance of offer, with consequent barrier to entry and limit on competition.
Where a development is subject to high 'Local' costs plus high TNUoS due to location – the total charges may even exceed the current full FSL (100% carried by developer) 'status quo scenario.
This is particularly bad for Island developments.

<u>Remarks on all the above</u>

- Date stamping should be the starting point for any proposed change which contains elements of reinforcement costs as the basis for securities.
- High entry costs – which are levied at a time irrespective of real costs incurred to the TO – should be avoided, since they are a real barrier to entry and will act as an artificial limiter to competition. This would, in our opinion, rule out a multiplier of annual TNUoS as an up-front levy. If a fixed cost element were to be tied to consents (i.e. paid after a developer had achieved consents) – then it may give the necessary confidence to the TO to continue with 'deeper' reinforcements.

- If we count the present situation for FSL as the worst case, then 'Local' FSL plus fixed sum (of which fixed sum payable on day one) is the next worse case. This is particularly true for remote and Island generation (in renewable energy rich areas).
- 'Fixed sums only' would help to even out the entry liabilities for near- to-infrastructure and remote- from- infrastructure developers. Though the imbalance would return if fixed cost (unprofiled) were added to 'Local' FSL. This mechanism would still allow TO s to offset some of their liabilities for 'deeper' works from all users.
- 'Local' FSL only is advantageous for developers who need minimal local works, as described on their annex H. It is likely to be much less advantageous, however, for those with extensive connections to remoter areas where they may have deeper reinforcement as part of their H1 works.
- Most of the options explored do not take into account the relative exposure of investment pre and post planning consent. The nearest would be the 'fixed sum and profile' model.
- Where higher securities (in whatever form) are necessary to retain the defence against stranded assets – a loading to post planning consents would be highly beneficial to entry and would boost competition.

Onset of TEC, options for limited use of the system and trading is discussed later in the report – though we will comment only in respect of the 4 Illustrative Options.

Illustrative Options

Option 1

This option has one advantage (only) over the existing securities system in that it is 'date stamped'
The TEC in 2 years is very much watered-down with the proviso that it is only counted after the TO has gained consents for all works 'deep' and 'local'. This could leave allocation of TEC just as uncertain as it is now.
FSLs would still be very high and would continue to operate as a barrier to investment by developers.
FSOL sees no advantage in adopting this system.

Options 2-4

These options are effectively close variants of the 'Local' FSL plus fixed sum model. We have described this as the next worst scenario to the present case (or Illustrative Option 1).

As they are so closely related – we have used Option 4 as the model of comment. This option, at least, develops some of the issues of interim rights, new products and trading of capacity - –which would be a step forward. This model also treats new and existing holders of TEC in a more equitable way.

The 'TEC plus 3 years' is an interesting proposal - if, say the developer could elect to pay the fixed sum at the point of achievement of planning consents for the generating

plant. A major drawback, however, might be that the TEC available to use at the end of the 3 years may be highly restricted. Would full compensation be paid to a TEC holder after three years if they were unable to transmit the full allocation?

Is it assumed that the Local FSL is inherently 'date stamped' as it only affects the single user? This may not be true if local works still cover some shared assets.

'Less firm rights' is interesting but would, presumably still be contingent upon the ability to use existing wires. This may be very limited or non-existent in an Island context.

Local works, as discussed earlier, are likely to be very significant for remote and Island-based developers. In these cases Local FSL plus fixed sum may be very close to –or even exceed the securities demanded by the current system.

Having said that – for many entrants, option 4 would provide some relief from the problems associated with lack of transparency, volatile and high FSL and indeterminate allocation of TEC.

For remote and Island based developments please consider the following as a suggestion:

Local (H1) FSL as above but capped in the same way that TNUoS is discounted. The rest of the package as option 4. An option to pay the fixed sum after a developer has been granted planning consent – leaving the developer with the choice to wait longer for TEC – would be beneficial.

We are not told how the fixed sum security will eventually fall away – Would this be upon connection (as the FSL) or after 5 years payment of TNUoS?

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6.7.06