Highlands & Islands
ENTERPRISE

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6 June 2006

Dear Mr Copley

Response to Ofgem Consultation on Access to Transmission System – Report by Access Reform Options Development Group

You may be aware that the Highlands and Islands of Scotland are home to much of the UK's renewable energy resource. Development of that sector is a key priority for Highlands and Islands Enterprise (HIE), the Government's economic and social development agency for the area, given the wealth of economic development opportunities it could offer. For that reason, HIE, and its local partners (Shetland Islands Council, Orkney Islands Council, Comhairle Nan Eilean Siar, Highland Council, Argyll & Bute Council and Moray Council) have taken a close interest in regulatory developments and have responded to a number of consultations issued by Government, Ofgem and NGC.

HIE and its partners welcome the opportunity to respond to this consultation. This response should be read in tandem with our response to the third consultation on the Transmission Price Control, which covers some overlapping ground. A copy of that response is attached for completeness.

ARODG's work and the industry / Ofgem consensus on the need for revised access arrangements is very welcome. HIE is wholly supportive of access reform, and would stress the need for timely solutions which enable developers and the network owners to move forward with substantial long-term investment decisions.

HIE recognises that there are some complex issues to be resolved, and that there may be a need for staged progression. Clearly it is desirable to implement robust arrangements which can endure ongoing changes to the makeup of the electricity industry. However, HIE would not wish this to deter from the need for workable arrangements for existing projects, and as such would suggest consideration of certain comfort measures which give a degree of protection to investments as and when they are entered into.

The remainder of this response provides comments against the main themes of the ARODG consultation.

1. EXISTING ARRANGEMENTS

HIE agrees that the existing arrangements are unsuitable for achieving timely, efficient and economic delivery of future generation and grid capacity, especially in the context of the grid queue in the North of Scotland. In implementing change, it will be important to respect the circumstances under which generators have made commitments to-date, and the legality of any change. There will need to be a balance between prioritising the strongest projects (against a set of clearly defined criteria) and ensuring that parties are not unreasonably disadvantaged. For instance, loss of a queue place has always been a possibility on failure to complete by an agreed date, but there should be reasonable scope for negotiation if completion is say, a matter of months away, or if there are strong grounds for reservation of capacity. Scope for reasonable negotiation is a feature of the existing arrangements.

2. SECURITY PROVISIONS

HIE is supportive of changes to the current requirements for credit cover for deep reinforcements, which it believes counters the benefits of a shallow charging principle. While we recognise the need to protect customers against paying for unused assets, the following observations are relevant:

- It seems unlikely, in reality, that there would ever be significant spend on major assets that are in the event unused. Planning and related environmental considerations tend to mitigate against consents for assets that have no demonstrable, and near-term, prospect of realisation. Consents for project-specific assets tend to be granted in parallel with the project itself. Thus, the highest risk of spend on projects which are not progressed is at the feasibility and planning stage – and an attrition rate at this stage is normal across most industrial sectors, and is part and parcel of the total cost of project development. In performing a transmission planning role, it is arguable that the system operator should in any case be investigating a wide range of options for system network enhancement.
- A requirement for credit cover arguably favours large utility-type companies where an existing credit rating is normally sufficient. It is also questionable whether, in the case of a Final Sums Liability (FSL) being converted to an actual cost, there is full protection against cost pass-through to the consumer. Presumably where an existing generator incurs this cost, this is passed through to customers via generation costs.

HIE believes that together with existing arguments presented by ARODG and Ofgem, there is a compelling case for relaxing, and in effect socialising, a proportion of the existing FSL requirements.

Comments against each option in the consultation paper are as follows:

Option (i) The Status Quo

HIE does not favour this option.

Option (ii) Date Stamped FSL

This has the benefit of protecting developers against variations in FSL of which they have no control. It does not however remove the barrier of a potentially large and / or disproportionate FSL to be incurred at an early stage in project development. It may also worsen the grid queue by adding to encouragement for generators to make an early connection application. E.ON's proposal for fixed sums against project milestones, reverting to a date-stamped profile post-consent, would seem to be preferable in this respect although it does not wholly avert the incentive for attempting to fast-track projects through the planning and grid application processes.

Option (iii) Local FSL

Projects are already responsible for the shallow element of infrastructure. The definition of "local" is important to this option, but in principle it would appear to have some merit in that cover is more likely to be commensurate with project size.

Option (iv) Fixed Sum

This has similar merits to option (ii) with the difference presumed to be that the sum is independent of date?

Option (v) Local FSL plus fixed sum

Comments against options (iii) and (iv) apply. The consultation also mentions separation of an application for CEC (maximum export capability) and TEC (permitted export onto the transmission system). HIE can envisage that this would be very beneficial where an application for CEC allowed export onto the distribution system prior to transmission system reinforcements, although it is not clear if this is the implication of the separation. In any event, connection in advance of transmission system reinforcement would allow progression of embedded power projects which are otherwise constrained by substantial, distant and long-term deep reinforcements.

HIE would also suggest consideration of:

Option (vi) Socialised FSL for feasibility-stage studies

HIE understands that this is in effect the option taken for Beauly-Denny, under the justification that there was strong evidence for take-up of the reinforced line, and following the results of a cost benefit analysis. HIE believes that there may be a similar case for other reinforcements to be classified as "baseline" where there is strong evidence of the political and / or industry commitment to project development in defined locations, and where revised costs benefit analyses indicate a justification for the investment.

Cover for provision of the physical infrastructure could be in stages against key project milestones. HIE favours an approach where the milestones and amounts are clear from the outset.

An alternative position might be:

Option (vii) Socialised FSL for post-feasibility-stage studies

In HIE's response to Ofgem's Transmission Price Control Review (appended) it was proposed that within the connection process there should be a formalised "sanity" break point after advance services, where progression of any development would be dependent upon agreement from all parties and require consideration of the status of planning consents, economically viable TNUoS charges, etc. Given that Ofgem would have to have at least a watching brief over this "sanity" break point then there should also be consideration at that point by Ofgem as to whether proceeding connection projects can be reclassified within Ofgem's Transmission Investment for Renewable Generation investment classification categories, thus potentially removing the need for FSL for projects with sufficient cost-benefit.

This option creates the principle of a phased connection process and also provides further opportunities for grid connection queue optimisation.

3. RESTRICTED ACCESS RIGHTS

This part of the consultation is concerned with the development of additional access products which allow use of the existing system to be maximised. The options are for variations on duration and volume-restricted access rights.

HIE has consistently promoted measures that would make better use of the existing grid system, and in the context of the grid queue this is principally technical measures which would allow more active management of power on the system, with occasional constraint. There is understood to be scope for these kind of measures in the North of Scotland and HIE would very much encourage the progression of the technical and regulatory actions required for implementation.

The consultation however implies a level of complexity in developing access "products" which will add to the existing contractual complexity in accessing the transmission system. It may be preferable to generators to rationalise contractual requirements such that constraint for instance could be managed through simple agreements on volumes and price, with best estimates of likely occurrence.

Proposals for reallocating access rights between parties appear to be an attempt to develop market-based products for the process of actively managing access – for instance where a low capacity factor generator with a firm TEC might wish to trade unused capacity. However, most wind energy generators in the North of Scotland have signed BELLAs, which is understood to be an agreement for a non-firm TEC. There has been no quantification of what this might mean financially for a generator, and as National Grid presently designs the system for firm connections, it would seem to-date that any distinction between a BEGA and BELLA on access rights had been rather academic.

Clearly a situation where generators with BELLAs were increasingly constrained by new connectees with BEGAs is untenable, especially where the constrained generation is contributing towards environmental targets, and where its consents presuppose best use of the available resources. A reasonable approach would be for occasional constraint which made best use of both the generating assets and the infrastructure in combination. An unreasonable, and unrealistic approach, would be for existing pollution-free, fuel-free generators to be progressively constrained off the system on the grounds of an ever-changing regulatory framework in the absence of virtually no change in the physical assets. It can be somewhat frustrating where market arrangements are developed which are apparently divorced from the reality of a situation.

HIE consider that any changes to the access regime should allow generators with BELLAs to continue generating with minimum constraint, or, if they cannot accept constraint, an option to change their access agreement without compromising their connection agreement.

4. UNRESTRICTED ACCESS

This chapter essentially seems to be covering the issue of managing the grid queue through the development of better defined access products. HIE would again comment that it is important that proposals are workable. In particular, while a "connect and manage" type approach may have merits in facilitating best use of existing capacity through economic signals to National Grid, it is difficult to see how it might work for strategic reinforcements, such as the significant island connections. Planning delays are largely outwith National Grid's control and it does not seem in the interests of efficiency or economy to make significant constraint payments for projects that may never be realised.

The report falls short of tackling the presumably rather contentious issue of options for prioritising projects according to defined criteria. This is covered in the National Grid report on its access seminars as a project "score card" and is an approach which has been adopted relatively successfully in Ireland. A "connect and manage" product (as option *iii*) does not reflect this value estimation and applies capacity to only the fastest projects. While this is not a bad thing per se, it should not be the only option and it is important to retain flexible alternatives for developers with viable projects.

HIE does not believe that the grid queue can be rationalised simply through a test of the extent to which users are prepared to reserve capacity through payment. This does not necessarily promote the "best" projects, or encourage timely delivery of environmental benefits. Furthermore, a generator's place in the queue is somewhat circumstantial in the context of many GW of applications in a short space of time.

The "sanity" break point mentioned previously would add opportunities for developers within the process to reach (or fail to reach) important milestones and commit further thereupon. This brings externalities such as planning permissions into the connection process informally and gives developers further options to exit the connection process rather than advance into significant commitments (FSL or committed costs). The increased opportunities for developers to leave the queue would support queue rationalisation efforts.

Clearly actions to rationalise the queue have the potential to raise controversy and it will be important to act transparently. HIE would highlight the potential of some projects which could move forward were they not, perhaps unnecessarily, contingent on queue movement elsewhere. This includes:

- Embedded plant which may be accommodated in advance of reinforcement
- Outlying projects which may have the potential to progress in advance of clusters of interactive, variously progressed, projects.
- The potential for voluntary collaboration between adjacent projects

5. ILLUSTRATIVE OPTIONS

The illustrative options are helpful as a starting point, but it would be useful to develop these into specifics, including actual costs, and to consult on the potential uptake from industry.

We hope you find these comments useful.

Yours sincerely

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Head of Renewables

On behalf of a Highlands &Islands partnership comprising:-
Highlands & Islands Enterprise
Shetland Islands Council
Orkney Islands Council
Comhairle Nan Eilean Siar
Highland Council
Moray Council
Argyll & Bute Council