

**Transmission Price Control Review: Initial
Proposals**

**Consultation response from the Renewables
Advisory Board**

July 2006

Executive Summary

The Renewables Advisory Board (RAB) was established by the Energy Minister to provide him with advice on policies, programmes and measures to tackle barriers to the development and deployment of renewable energy sources within the UK.

RAB membership is comprised of key players from the industry, academia and other important stakeholders. It endeavours to provide the Minister with independent, impartial and authoritative advice on all relevant issues.

This document presents RAB's response to Ofgem's Transmission Price Control Review: Initial Proposals (publication 26 June 2006). As expected RAB has focused its response on the questions raised in the consultation document of relevance to renewable energy. We hope you find our response helpful as you take forward this price control review.

Generally the Renewables Advisory Board welcomes the review, and the general thrust proposed by Ofgem, particularly in terms of efficiency, flexibility and the allocation of risk. In summary the RAB would like to see:

- The transmission licencees are incentivised to invest in their networks in an efficient, effective and cost reflective manner that does not discriminate, or result in undue connection delays.
- Strong, effective and fair governance of the transmission licencees.
- A two part flexible revenue driver is welcomed to respond to the needs of the system.
- That the balance of risk is fair and efficient between the transmission licencees and the system connectees.
- That funding for innovation is encouraged provided this results in real benefits to the users of the transmission system.

The RAB would like to provide further input to the TPCR as it progresses as well as issues not considered in the current document, but of concern to the renewables community, in particular fair and equitable access arrangements for renewable generators.

Response to the Ofgem June 2006 TPCR: Initial Proposals

7.3 Question from the TPCR document	RAB Comments
<p>Is our assumption on efficient connection design for wind generation, and the associated reduction to some of the company cost forecasts, appropriate?</p>	<ul style="list-style-type: none"> ○ Connectees should be able to choose less secure, efficient connection designs, possibly accepting some loss of revenue due to constraints if the chosen connection falls below that suggested by the application of appropriate design standards. It is appropriate that a commensurate level of security is taken into account (which is likely to be less than the current standard) when preparing transmission companies capex forecasts. ○ If this approach is to be taken then how the principles of economic and efficient connection designs is applied should be transparent and in the public domain. ○ Any resulting reduction in capex should flow to the causing parties. This process should not create any perverse incentives. ○ The SO should be responsible for constraints over and above any agreed annual constraint volume ○ As far as the valuation of constraint costs is concerned, it is agreed that economic fundamentals rather than observed market prices should be used. However, it is unclear how NGET can be expected to properly balance operational measures against investment when there is over-recovery though the existing constraint mechanism. ○ Although there are a number of studies to review security of supply in the context of the changing profile of generation (particularly intermittency) there should also be a major review of the Grid's generation connection standards. ○ Consideration needs to be given in such arrangements to the EU directive on priority despatch of renewable generation.

7.4 Question from the TPCR document	RAB Comments
<p>Do you think that we need to allow explicitly for the possibility of reopening the price controls for specified single events where the timing and level of costs is uncertain and driven by third party decisions? If so, what might such events be and why?</p>	<ul style="list-style-type: none"> ○ Extreme events will be difficult to capture by generic cost drivers and there is the possibility of setting these incentives incorrectly. It therefore seems sensible to allow for the need to reopen the price control. In setting the incentives however, it may be prudent to err on the side of a rigorous economic business case to ensure that transmission companies have a real incentive to connect generation and to ‘cover’ as many “expensive” connections as possible. ○ The appropriateness of any such mechanism depends on how it is implemented. In the past OFGEM’s transparent approach to such events has been a major reason why they have been accepted by users. Such transparency would be aided by further statements as to the principles on which such events are assessed. These principle should include: <ol style="list-style-type: none"> 1) whether the transmission companies can reasonably have been expected to anticipate such events 2) did the transmission companies asked for that type of event to be taken into consideration when their charges were set and were refused 3) whether the risk and cost of such events are implicit in the rate of return allowed. ○ In the last price review period the TIRG/RETS work was a good example of such an income adjusting event. The proposed two part revenue driver in this price review should avoid such events in the future but there is a need for a mechanism to challenge allowable costs during the price review.
7.5 Question from the TPCR document	RAB Comments
<p>: What do you think of our proposed options for setting incentives for efficient capital expenditure?</p>	<ul style="list-style-type: none"> ○ RAB support the view that the increase in capital expenditure related to the connection of new generation and asset replacement means that a different approach to incentives relating to capital expenditure is required. However, for incentives to be effective, they will need to be set at a level which provides licensees with a strong business case to invest.. ○ Both the proposed approaches have merits. The “information quality incentive” has the benefit of the DPCR4 experience but in depth scrutiny may be more appropriate given that transmission investments are usually of a size that justifies individual examination. ○ Any incentive needs to be structured so as to encourage Licensees to complete infrastructure projects as quickly as possible and offer the earliest possible connection dates.

8.2 Question from the TPCR document	RAB Comments
<p>Are there any other measures which could be taken to reduce perceptions of regulatory risk and what level of risk do these regulated utilities carry relative to other plc's?</p>	<ul style="list-style-type: none"> ○ The fundamental principle of risk management is that risk should be taken by those best able to control its impacts. When this principle is applied alongside the need for parties to see the cost of their own actions the result may involve a greater transfer of risk to the transmission companies. ○ Examples include the approach that the transmission companies should not be held responsible for works that are terminated by potential connectees. On the other hand the transmission companies should be accountable for the management of spend on such projects so they should be responsible for committing to a firm user commitment profile before material expenditure commences. They should also be capable of managing network enhancements that are needed to support multiple new users. ○ The new proposals to change the termination amounts faced by new connectees are welcome. However, there is concern that the risk has merely been transferred to existing users. It doesn't immediately appear that the transmission companies have seen any increase in risk. For management of large infrastructure projects that will be of benefit to multiple users (including demand) the risk should lie with the transmission companies.
10.1 Question from the TPCR document	RAB Comments
<p>Is our proposed two-part revenue driver design appropriate and proportionate to the issue it is seeking to address?</p>	<ul style="list-style-type: none"> ○ The two part revenue driver is appropriate and should encourage the use of optimising generation connections via means other than construction of new capacity. ○ To encourage efficiency, revenue should be triggered by delivery of physical capacity rather than user commitment. Cash flow issues should not override the benefit of linking payment to physical delivery. ○ Again, it is important that drivers are set at a level which gives transmission licencees a real incentive to connect generation as quickly and efficiently as possible.

10.2 Question from the TPCR document	RAB Comments
<p>What are the costs and benefits of seeking to facilitate greater competition between providers of transmission services, in respect of the prospective transmission links to the Scottish Islands?</p>	<ul style="list-style-type: none"> ○ Competition is an effective way of encouraging efficiency. It is also particularly pertinent where the nature of the investment requires different technological solutions and where asset duplication is manageable. Offshore and Island connections meet both of these criteria. ○ It is important that as much competition and contestability is introduced to the area of connecting generation and providing links to ensure that both costs and construction timescales are minimised.
10.3 Question from the TPCR document	RAB Comments
<p>Is our proposed approach to funding for innovation appropriate and necessary?</p>	<ul style="list-style-type: none"> ○ Funding for innovation is appropriate and should be encouraged. The recommended approach should be transparent, and the involvement of users should be encouraged. RAB would support additional funding being made available to explore commercial innovation as well as technological developments. ○ Examples of commercial innovation might include further developments of “connect and manage”, different levels of connection “firmness” and the development of a frequency response market.
12.1 Question from the TPCR document	RAB Comments
<p>Do you agree with our assessment of the main impacts of the transmission system? What are the most important impacts from the perspective of consumers?</p>	<ul style="list-style-type: none"> ○ RAB agrees that these are the main impacts of the transmission system on the environment. ○ NGET in particular need to be encouraged to take a more pragmatic approach to the use of underground lines versus overhead lines. The risk of delay to projects due to the delay in consenting of OHLs should lie with the transmission companies and connectees should be given the choice of opting for an earlier connection at a premium to reflect the transmission company taking the consenting risk should be explored. ○ Notwithstanding the above, the ability to control risks not directly in the transmission companies’ control is questionable. For example, planning consent risks and the associated costs is very difficult for either the transmission licensee or project developers to control.

<p>12.3 Question from the TPCR document</p>	<p>RAB Comments</p>
<p>Should there be additional measures to promote innovation in support of environmental benefits, either as part of the proposed incentive scheme for innovation for NGET, SPT and SHET or as a separate measure?</p>	<ul style="list-style-type: none"> ○ Whilst additional measures to promote innovation in relation to environmental issues are to be supported, the value flowing to the transmission companies must be appropriate. ○ The transmission companies should be responsible for encouraging users to minimise losses and it is not unreasonable for them to receive a small share of the value created. Such a share should be no more than 10% and the bulk of the value saved should be used to encourage users to reduce losses. ○ On the issue of encouraging innovation generally, there may in some instances be a case for allowing transmission companies to retain a proportion of the benefits resulting from innovation over a longer period, rather than keeping all of the benefits for 5 years only. Knowing that they would retain some benefits over a long period would encourage the transmission companies to embrace innovation as early as possible.