

**Transmission Price Control Review:
September 2006 Consultation 'update proposals'**

**Consultation response from the Renewables
Advisory Board**

October 2006

Response to the Consultation

The Renewable Advisory Board (RAB) welcomes the opportunity to comment on Ofgem's updated Transmission Price Control proposals. As you are aware the RAB, which is chaired by the Energy Minister Malcolm Wicks, provides advice to the Government on a wide range of renewable issues.

In responding to Ofgem's updated proposals we have addressed a number of the specific questions set out in the consultation document. Before embarking on the detail however, we would like to make a number of more general observations on the updated proposals in the context of the delivery of the Government's renewable targets and aspirations.

In addition to significant transmission infrastructure development, the period covered by the new Transmission Price Control will need to see major changes to the access and connection arrangements applying to renewable generation if the Government's renewable targets and aspirations are to be realised. The RAB would like to be assured that the allowances within the price control will be sufficient for the expected levels of renewables integration over the price control period. While accepting that the updated proposals include innovative measures in the form of revenue drivers that should allow the Transmission Operators to respond more flexibly to the needs of system users, it is disappointing that the issues of access and connection timescales receive so little attention. The RAB would welcome a flexible approach to security standards in relation to intermittent generation, both 'on' and 'off' shore.

Delivering the Government's targets imply the need for some 12GW of renewable generation to be connected by 2010, rising to 25GW by 2020. If this amount of capacity is to be connected in the required timescales, fundamental changes to the access arrangements for renewable generation will need to be introduced and measures taken that will allow available transmission capacity to be utilised more effectively. Earlier in the year, the ARODG developed promising options in both these areas and it is a pity that the output of this Group did not feature more prominently in the consultation document. At a time when events demand major changes and developments in these areas, Ofgem's updated proposals effectively represent "business as usual".

The issue of risk continues to be a concern to renewable generators seeking to connect to the transmission system. The RAB believes that the allocation of risk should be to those best able to manage it, and that this should be fairly balanced between the transmission operators, the system operator and the users of the transmission system.

We are also disappointed to note that the development of the GBSO Price Control will be the subject of a separate consultation. In the coming years we will face increasing uncertainty in terms of which renewable projects will commission and when, at the same time many conventional generating stations will approach the end of their working lives. This increased uncertainty would best be managed by incentivising the GBSO and TOs to optimally balance investment in transmission assets with the use of operational measures. This will then minimise the risk of transmission assets becoming stranded. This opportunity appears to have been lost with the development of separate TO and GBSO price control reviews

Response to the Ofgem September 2006 TPCR: Initial Proposals

7.1 Question from the TPCR document	RAB Comments
<p>Do you agree with our proposed incentives for efficient capital expenditure, including a 25 per cent incentive rate?</p>	<ul style="list-style-type: none"> • Could Ofgem provide their rationale for choosing a 25% incentive rate. • Given the difficulty of measuring 'outputs' in relation to transmission, a level of incentive of 25% seems high. <ul style="list-style-type: none"> ○ If a level such as 25% is to be used then we recommend that a detailed audit is carried out. ○ Such audit would not be intended to claw back money (except in the case of clearly inappropriate failure to invest) but to give users confidence and to inform future price reviews. ○ 'output' measurements such as MW connected should be considered
7.2 Question from the TPCR document	RAB Comments
<p>What do you think about our proposals to address significant capex under spend? In particular: (1) What action should we take if this happens? (2) At what level should we trigger this response? (3) Should this response apply to load related and non load related capex?</p>	<ul style="list-style-type: none"> ○ Clearly RAB is more concerned with new assets that enable the connections of renewable generators ○ Capex under spend may occur for reasons outside the control of the TOs, e.g. delay in receiving planning permission. This should not result in a windfall gain for TOs. It is thought the MW trigger for additional capex will partially address this issue. ○ A re-opener trigger does not seem unreasonable though as the TOs will certainly request a re-opening if new costs arise. RAB would propose that the underlying concept should be to encourage best use of consumers money, so TOs should be incentivised to find ways of avoiding capex and the implications of such avoidance should be the subject of a comprehensive audit. ○ The TOs should be able to avoid capex safe in the knowledge that benefits to them will not be clawed back. We therefore suggest that an audit is carried out after 3 years or after cumulative capex savings of an appropriate amount [say 15% although this would need a more thorough economic appraisal]. This audit could then indicate any possibility of a re-opener and at what amount of cumulative capex savings this would take place. This audit could also take the form of a benchmark study across UK and other transmission networks. ○ Whilst such mechanisms are harder to apply in relation to load related capex there is no underlying reason why both load and non load capex should be treated differently.

7.3 Question from the TPCR document	RAB Comments
<p>Do you agree with our proposed approach for dealing with uncertain costs including future input price changes, specific cost uncertainties, and wider regulatory developments?</p>	<ul style="list-style-type: none"> • Where the regulator has a view of regulatory developments these should be made visible to the industry. • The approach of wait and see would seem appropriate for developments outside of the regulators control.
8.1 – 8.3 Question from the TPCR document	RAB Comments
<p>Question 8.1: Do you agree with the conclusions of the Smithers & Co cost of capital study, in particular the real cost of debt and equity? Question 8.2: Do you agree with our proposed revised treatment of pensions costs? Question 8.3: Do you agree with our proposed approach to the provision of new equity?</p>	<ul style="list-style-type: none"> ○ No comment on cost of capital. ○ The consultation does not specifically address the issue of risk taken by the TOs. At present TOs take virtually no risk even to the extent of passing through costs within their control (e.g. cost overruns and delays in relation to construction costs). ○ Whatever cost of capital is agreed upon it should be on the basis of TOs accepting full responsibility for their own actions and matters within their control.

9.1 Question from the TPCR document	RAB Comments
<p>Do you agree with our proposal that it is appropriate for NGET to have a different form of revenue driver from SPTL and SHETL?</p>	<ul style="list-style-type: none"> ○ RAB is of the view that the incentive properties are inherently different for all the transmission operators, although there should be commonality, with different weightings, in how the revenue drivers are derived. It would be expected that there will be differences because for NGET's role as System Operator. ○ The adjustment mechanism is welcomed by RAB but we also recognise that such a novel approach may not work exactly as intended. ○ Using two approaches will also enable the effectiveness of both to be established and thereby ensure a better mechanism (if appropriate in a future price control).
9.2 Question from the TPCR document	RAB Comments
<p>Do you agree with our proposed mechanism to deal with baseline and revenue driver sample risk?</p>	<ul style="list-style-type: none"> ○ The issue of cost uncertainty is recognised and the "sample risk" mechanism would seem to reflect an effective way of allowing for this difficulty.
9.3 Question from the TPCR document	RAB Comments
<p>Do you agree with our proposed split of revenue recovery between pre-connection and completion?</p>	<ul style="list-style-type: none"> ○ RAB's view is that the additional capex allowance should not come in till the work is completed or at least with a profile similar to the spend. A 75% weighting towards the early phase does not conform to RAB's expectation of the profile. ○ If an early allowance is to be made then it should also be linked to the TO obtaining all consents. This would provide the TO with additional incentive to ensure consents are obtained in a timely manner.

9.4 Question from the TPCR document	RAB Comments
<p>What are your views on the appropriate method of providing connections to the Scottish Islands?</p>	<ul style="list-style-type: none"> ○ Monopoly provision is appropriate wherever building of an integrated system does not allow for multiple assets. ○ Connections to Islands can be provided competitively, in fact, there are parallels with interconnectors and offshore transmission which are both outside of the traditional regulatory regime. Islands may be connected to the mainland without involvement of the incumbent System and Transmission operators. ○ RAB supports the concept of alternate regimes for connection of the Scottish Islands.
9.5 Question from the TPCR document	RAB Comments
<p>What additional output measures do you think Ofgem should capture when considering system performance?</p>	<ul style="list-style-type: none"> ○ The logic, that the difficulty of measuring the quality of 'outputs', supports the approach of a penalty only mechanism is not particularly robust. ○ Asymmetric incentives are considered always problematic. ○ If penalties are one sided though they should not be excessive.
9.6 Question from the TPCR document	RAB Comments
<p>Do you agree with our view that an Innovation Funding Incentive is appropriate?</p>	<ul style="list-style-type: none"> ○ An Innovation Funding Incentive is supported by RAB. ○ Such innovation should address commercial as well as technical issues. ○ Specific local (i.e. groups of GSPs) experiments should be encouraged. However there should be fewer issues with innovation at TO level as there are fewer transmission connected consumers. ○ RAB's view is that the TOs should be obliged to demonstrate that it is taking material steps to reduce costs to consumer by studying ways of transmitting MW at least cost.

11.1 Question from the TPCR document	RAB Comments
<p>Do you agree that the licensees should be incentivised to reduce leakage of SF6? Do you agree the incentive should be set for 5 years?</p>	<ul style="list-style-type: none"> ○ Given that no other incentives to reduce SF6 emissions exist then the approach proposed should apply until such gases are covered by the EU ETS.

11.2 Question from the TPCR document	RAB Comments
<p>Do you agree with our proposal not to apply the DPCR approach to transmission under-grounding? Do you have views upon how we may best factor this in to our decisions?</p>	<ul style="list-style-type: none"> ○ Case by case is probably the best approach for dealing with under-grounding. ○ The impact on users by either incurring extra costs or by delaying connections should be considered as part of any assessment. ○ To the extent that generators wishing to connect should be able to propose that under-grounding should be used. ○ If users are unhappy with NGET's response to their proposals (which they believe to be economic) then they should be able to refer such a response to OFGEM.¹

¹ For example, if a potential connectee offers to pay for a section of under-grounding to speed their connection (eg through the planning process) and offers NGET a share of any resulting benefit