

Robert Hull
Director – Transmission
Ofgem
9 Millbank
London
SW1P 3GE
robert.hull@ofgem.gov.uk

17 July 2007

Your Ref: Ofgem doc 138/07

Dear Robert

Connecting the islands of Scotland

energywatch welcomes the opportunity to respond to the issues raised in the open letter. This response is non-confidential and we are happy for it to be published on the Ofgem website.

Consumers expect the delivery of safe, secure and reliable electricity supplies in an efficient and economic manner. The operators of transmission networks and National Grid as GB system operator are under licence obligations to ensure that consumers' expectations are met.

In addition, the islands, due to their rural profile have some of the highest levels of fuel poverty in Scotland. Solutions which reduce energy costs in the short and long term and provide greater security of supply would be a welcome addition to achieving governmental targets on eliminating fuel poverty.

We note that the debate about connecting the Scottish islands is occurring at the same time as BERR and Ofgem consider in detail the offshore electricity transmission regime within a wider context of delivering sustainable energy and security of supply. We believe that there are some parallels in the potential solutions for connecting the Scottish islands and offshore transmission connections. BERR and Ofgem must ensure that detailed solutions in either case meet consumers' broad expectations as set out above. This will mean (not in any particular order of importance):

- Competitive transmission connections – Ofgem should explore the possibility of competitive connections to the islands which ought to provide least cost solutions as competition tends to drive down costs. We recognise the risk of stranding assets if developers of the connections cannot obtain effective user commitment for the capacity once the assets are built, with the costs of stranding lying with consumers. A balance therefore needs to be drawn. We do not believe that the connections should simply sit within Scottish Hydro Electric Transmission Limited (SHETL)'s existing transmission owner activity, even though such a regulatory regime may be superficially attractive. As with offshore transmission, the GB system operator has a significant role to play in carrying out feasibility studies which will determine the most safe, secure, efficient and economic interface between the mainland grid and island connections;

- Sustainable energy goals (large-scale generation) – securing safe and reliable connections to the islands creates the potential benefit that large-scale renewable generation projects planned for the islands can be realised, providing opportunities for this generation to access the whole GB market. The increased use of renewable generation would add to the diversity of the electricity fuel mix, creating greater long-term security of supply for all GB consumers. Large-scale projects have the benefit of economies of scale which should potentially keep longer-term energy costs down for all consumers;
- Sustainable energy goals (small-scale generation) - more locally, improvements to large-scale transmission infrastructure could allow the wider development of microgeneration or small-scale renewable energy projects on the islands. We believe that will add to the diversity of generation available and accessible to local consumers on the islands and provide greater energy security to them as a result. Access to local generation, and the development of community-based CHP and other schemes could provide fuel poor consumers with more innovative solutions which address the problems they currently face.

While we note some of the benefits of effective solutions to improved transmission connections to the islands, we are mindful of the disadvantages. Stranding of assets, whose costs will be passed through to consumers, is one. We are also concerned that Ofgem should ensure a balance is maintained which does not disincentivise potential generation developers. Greater cost reflectivity of transmission charges inevitably means that zonal charging adversely impacts generation the further it is away from demand. This would be a major disincentive to potential developers of the transmission connections looking at cost recovery and developers of generation itself. Conversely, demand transmission charges would be more negative but this does not tally with sustainable energy objectives aimed at reducing usage. Ofgem must consider these impacts further.

We believe that there are advantages and disadvantages to the various regulatory regime options outlined by Ofgem. We have noted our preference for more competitive connections but also the potential issues raised by a fully merchant approach. Ofgem must ensure that the licence offered to a competitive operator obliges them to optimise the use of capacity to limit the costs to consumers. Effective user commitment is one way forward. Ofgem must be willing to take effective action if operators act in ways contrary to the interests of consumers. We are reserve further comment until increased detail on the options is made available.

Going forward, we will continue to keep these issues under review as and when they are raised, always considering the possible impact on consumers. We will not be able to attend Ofgem's proposed workshop but would appreciate being kept informed of progress on this and related issues to enable us to comment as the need arises.

If you do wish to discuss our response further please do not hesitate to contact me on 0191 2212072.

Yours sincerely

Carole Pitkeathley
Head of Regulatory Affairs