



Highlands and Islands Enterprise
Iomairt na Gaidhealtachd 's nan Eilean

Robert Hull
Director – Transmission
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Ofgem
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19 July 2007

Dear Mr Hull

Connecting the islands of Scotland – Response to Ofgem Open Letter

As you are aware, Highlands and Islands Enterprise (HIE) is the Government's agency responsible for economic and community development across the northern half of Scotland. Along with its local partners (Shetland Islands Council, Orkney Islands Council, Comhairle Nan Eilean Siar, Highland Council, Moray Council and Argyll & Bute Council), HIE has taken a considerable interest in, and has responded to a number of consultations on, issues affecting development and access of grid infrastructure, particularly those relating to connection of the islands. HIE is aware that certain of its Local Authority partners have responded separately to this consultation.

HIE welcomes the opportunity to respond to this informal consultation on the options for providing island connections. The islands of Scotland have substantial renewable energy resources and have the potential to make a huge contribution towards UK renewable energy and carbon reduction targets. Developing this resource could also make a significant contribution to national energy security and sustainability. A key challenge for Government, the regulator and the electricity industry is to make effective and economic use of this resource and to develop a regulatory framework fit to support it. The consultation comes at a time when a number of proposed island projects are reaching a critical stage and the issues it raises are therefore in need of immediate attention.

HIE and its island Local Authority partners have recently published work by Xero Energy which identifies the key issues and regulatory constraints to the development of the renewables sector across the North of Scotland. Our comments in relation to this consultation should be read alongside that report which is available at <http://www.hie.co.uk/islands-grid-strategic-view.html> and which has also been sent direct to Ofgem.

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Careers Scotland in the Highlands and Islands is part of the HIE network.



1. General

In general, HIE and its Local Authority partners welcome and support Ofgem's aims in running this consultation exercise. As described above the need for investment in island connections is critical to the ability to access the huge renewables resource of the islands (onshore wind, but also wave and tidal in the future) – this is important not just in local economic development terms given the range of opportunity this sector offers the area, but also nationally given the role the islands could play in meeting national and European targets.

2. Timing

After receipt of comments on the open letter, Ofgem intends to proceed to develop more detailed models 'for discussion during the latter half of 2007'. HIE is concerned that this programme does not match the urgency of the situation, either in terms of meeting project developers' needs or in terms of meeting Westminster and Holyrood targets for renewable generation.

HIE also notes that a simplistic approach to timescales based merely on achieving Government targets by the target dates misses two important points:

- The lowest cost to consumers will be achieved by building the necessary renewable generation capacity at a steady rate. The boom-and-bust cycle of wind development in the US brought about by the Production Tax Credit method of financial support has clearly raised costs. It has also favoured foreign wind turbine manufacturers at the expense of a local (US) industry, as they have greater ability to even out demand over other markets.
- It is now clear that the need to reduce atmospheric emissions is critical, and a tonne of CO₂ saved now is worth significantly more than a tonne saved later.

To put both these points in terms that might fit Ofgem's remit, there are strong arguments that the lowest cost to consumers of reaching desired objectives on climate change will be achieved by acting rapidly now, rather than merely achieving target quantities by target dates.

HIE is sure that Ofgem will develop a more detailed programme, after receiving responses to the open letter. HIE encourages Ofgem to ensure this programme is significantly faster than currently envisaged.

However, HIE would note that SHETL is already advancing connection options for the island groups. The benefit of the current proposals will be if they are able to reduce timescales and costs of connection – current applicants would need to be clear that this would be the case. Otherwise, the introduction of a new process which takes some time to implement would further disadvantage those island developers who are already pushing, against the odds, to ensure their projects remain viable. SHETL's proposals should be scrutinised for ability to deliver on the grounds of cost, but also timing and wider impacts. Alternative approaches should only be pursued for existing projects where they can realistically offer an 'all-round' better option (e.g. reduced costs, lower impacts in terms of onshore connection requirements, and at least within existing timescales). If that cannot be achieved then alternative approaches should instead concentrate on future projects.

Finally, HIE and its Local Authority partners have made representations to Government about the implementation of the s.185 cap. Uncertainty over the implementation of the cap

continues - issues such as the level of the cap and concerns over its effectiveness given the proposed 5 yearly reviews and 2024 cut off remain. Although these are matters for Government it is important that in taking forward these proposals Ofgem ensures that the cap can be applied under whichever scenario is adopted.

3. Support for renewable generation or for peripheral communities

It is clear that in Ofgem's view, it is not able to favour renewable generation, any particular generating technology, or indeed any particular geographical area. Ofgem's evaluation of options must therefore be restricted to questions of cost and risk for consumers while being recognising its environmental responsibilities.

The letter notes that new or stronger connections to the islands may meet the broader aims of Government or other stakeholders. It is possible that these stakeholders may be able to justify providing financial support for some options, for this reason. However, HIE is concerned that this would effectively concentrate risk from the entire UK customer base onto a handful of organisations.

Ofgem's open letter rightly points out the wider benefits from transmission grid connections to the islands. However, it does not take into consideration the ongoing subsidy needed to keep island tariffs down to the mainland level or the cost of replacing ageing power stations on the islands. If these costs were factored in to the overall economics of island connections it would give a fairer reflection of the cost impact these investments would have on consumers.

HIE therefore proposes that Ofgem establishes how the possible broader benefits of particular options, including those benefits achieved by support from other stakeholders, are to be taken into account in the final decision. If Ofgem is not able to take account of these issues in its final decision, some other mechanism may have to be found within Government to ensure this is achieved.

4. Advantages to SSE distribution and generation

New connections to the island groups, in particular Shetland, would provide significant benefits to SSE's distribution and generation interests, in terms of reduced costs and improved reliability. Ofgem should consider how these benefits may be taken into account.

5. Location of connection point to the existing transmission system

Options (b) and (c) offer the potential for reduced costs by allowing some form of competition to build and operate the new transmission infrastructure. However, it appears that the connection point to the existing transmission system is still to be decided by the System Operator and treated as a 'given'.

It is possible that organisations tendering to provide the new works may come up with alternative connection locations which offer cost savings. Ofgem should consider whether to provide for this eventuality in the agreed process, or to trust to the initial SO studies to fully evaluate all possible options, and therefore not permit any alternative connection points.

6. Specific comments on Option (a): The status quo

Liability for costs if generation projects do not proceed

Ofgem should consider how Final Sums Liability or similar might be allocated in this case. National Grid has required developers of projects to sign up to very significant liabilities, and this has prevented some projects from proceeding. As the costs of connections to the islands will form a larger part of total project costs than for projects on the mainland, the liability for these costs is a relatively more important issue.

Multiple projects

This option does not easily deal with the likely case of multiple projects. The formal position is likely to be that SHETL should consider only the connection capacity applied for by the first developer, until further applications are received. Ofgem should consider alternatives, by which further projects can be taken into account. SHETL is also relatively well advanced with some island connection plans, particularly Shetland and the Western Isles. Ofgem should carefully scrutinise SHETL's proposals as described above as any alternative to the current proposals which lengthen timescales or result in higher costs will be unwelcome to project developers with existing connection offers/agreements.

Security of Supply

The open letter mentions the requirements of the GB Security and Quality of Supply Standard (SQSS), and notes that changes to SQSS may be appropriate for these locations. The letter appears to recommend that changes are considered at the time of a connection application. HIE recommends instead that these issues are resolved in this consultation process, at least in principle.

7. Specific comments on Option (b): Merchant approaches

General

While there may be some interest in this approach by existing TOs, it is noted that privately financed connections have been considered and ruled out for offshore wind. The uncertainties with this approach would suggest that strong reasons to pursue it, such as an indicated willingness from existing TOs to participate on this basis, need to emerge during this consultation.

Regulatory oversight of charges

It is not clear why Ofgem considers that this approach might require regulatory oversight of charges, unless Ofgem is concerned that there will be insufficient competition between possible 'licensed parties' to build, own and operate the connection.

Multiple projects

This option would in principle cater for the case of multiple projects seeking a connection.

Security of Supply

The level of reliability provided by the new connection can be negotiated between the project developer and the owner of the connection. A lower level of reliability than provided by current GB SQSS is likely to be the economic optimum.

Therefore, Ofgem should consider how the merchant connection is to be taken into account in the analysis by the SO of security of supply to existing customers within the island groups, given that the owner of the new connection may have contractual obligations only to the generation project(s), not to the SO or the regulated SHETL business.

8. Specific comments on Option (c) Tendering the right to build a connection

General

As previously stated, HIE and its Local Authority partners welcome competition as a means by which to reduce the cost of island connections, deliver efficient investments and do so in a timely manner.

If this approach is adopted it is important that the winning TO is not selected purely on economic grounds – the wider impacts, including environmental, should be part of the decision making criteria. This should include an assessment of the impacts for onshore connection and the impact this may have on timing. For example, Highland Council, while supportive of robust island connections being built, is concerned that decisions based on cost alone would force the shortest connection route to be chosen. If that were the case it could lead to significant delays if onshore routing options were contested – Highland Council's response to this consultation makes its views on this matter clear.

SHETL has advanced proposals for island connections – there would need to be certainty of improving these proposals (in terms of cost and time) for a newly introduced competitive system to benefit those projects already being advanced on the islands. There is therefore a need for Ofgem to scrutinise the current SHETL proposals and be clear that by introducing a competitive approach these proposals can be improved upon. Otherwise a competitive approach may be more appropriate as a mechanism to support the connection of future projects.

Multiple projects

This option would in principle cater for the case of multiple projects seeking a connection.

Security of Supply

It is not clear if it is proposed that the reliability of the new connection is to be lower than required by the SQSS. This will probably be advantageous to the project developer, as costs will be reduced. If so, then as for Option (b) it is not clear how the SO should take this into account when analysing the security of supply for the existing customers.

9. Summary of options

HIE considers that the three options identified by Ofgem are the sensible options to consider at the next stage. No other option has come to light. Whichever option is adopted it is important that all players have equal access to all information from current/previous studies undertaken, whether by SHETL, Crown Estate or others.

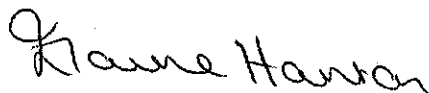
It is not clear at this stage that the potential cost savings of some options outweigh the additional complexity and possible delay. In particular, option (c) is likely to be more complex and introduce significantly more delay than option (b). It is in everyone's interest that connections to the islands are developed quickly and as efficiently as possible. It may be that different solutions suit different islands and it is important that local circumstances are fully taken into account during the decision making process.

The most significant risk to developing the islands' renewables resource is on going regulatory uncertainty and punitive transmission charging aimed at locating renewable generation away from the UK's most renewables resource rich areas. Ofgem's recognition of

the need to progress island connections and willingness to consider a variety of options is therefore greatly welcomed.

HIE and its partners would welcome the opportunity to meet with Ofgem officials to discuss these points further.

Yours sincerely



Elaine Hanton
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