

# Connecting the islands of Scotland – stakeholder workshop, 15 August 2007, Glasgow

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1.1. This note summarises the key issues raised during Ofgem's stakeholder workshop on connecting the islands of Scotland, both during the presentations and during the discussions that followed.

1.2. The following people presented to the workshop:

Robert Hull, Director of Transmission, Ofgem  
Colin Green, Head of Offshore Transmission & Projects, Ofgem  
Paul Neilson, Scottish Hydro Electric Transmission Limited  
Bill Grainger, Lewis Wind Power  
David Thomson, Viking Energy

1.3. Slides from the four presentations made on the day are available separately on our website, as is the open letter that preceded the workshop.

## **Introduction – Robert Hull (RH)**

1.4. RH introduced the session by setting out some of the history associated with connecting the Scottish islands. In particular, RH noted that the Transmission Investment in Renewable Generation (TIRG) process (2003/04) agreed substantial additional transmission investment outside the normal price control process, but did not consider it appropriate for additional investment to the Scottish islands at that time.

1.5. RH also noted that the recently concluded Transmission Price Control Review (TPCR) considered carefully the issue of investment to the islands. He outlined that the conclusion reached was that the revenue drivers built into the price control mechanism were not designed to handle the large-scale investment envisaged given both technology and design uncertainties and as such were not appropriate levers for investment of the scale necessary. However, RH did indicate that the TPCR final proposals contained a commitment on Ofgem to consider the issue further outside of the price control process – and that the June letter was the start of that process.

1.6. RH ended the introduction by confirming Ofgem's position that it wanted to take this opportunity to consider whether there were more efficient ways of providing transmission links to the Scottish islands than extending the existing monopoly provisions. RH cited a number of cases in the USA, Australia (specifically the BassLink project) and South America where a competitive solution had provided the most cost effective solution, and that it was opportune to consider whether this model was suited to the GB market.

## **Overview of Ofgem's initial thinking – Colin Green (CG)**

1.7. CG opened the presentation by outlining the three options presented in Ofgem's open letter – (i) the status quo (i.e. extending monopoly licences), (ii) the merchant approach and (iii) the competitive tender approach. The open letter and the slides provide the detail on these options so they are not considered here further.

1.8. As well as reiterating the contents of the open letter, CG set out that there were significant issues to consider as part of this project, including with regard to the security standards applicable to island transmission links, innovation and charging. He indicated that these would be taken into account in a further consultation document, due for publication later this year.

1.9. CG confirmed that this document would also flesh out considerably the issues considered in the June open letter – taking into account responses received and debate during the workshop and meetings that followed. Following that, initial proposals would be published in early 2008 with final proposals published in late 2008.

#### Discussion points

1.10. Assuming the status quo model, a question was raised as to why any re-opener of the price control would take up to two years to complete. The question was asked to highlight a concern that this additional delay would add to uncertainty and may lead to generators losing their TEC.

1.11. Ofgem responded to point out that a regular price control takes around two years to complete, so this would probably be the maximum length of time a re-opening would take. However, given the specific characteristics of any transmission investment connections to the islands, Ofgem would need to carefully assess the efficiencies of any additional expenditure made by a TO, and therefore to set expectations, stakeholders should be aware of the length of time a price control review takes.

1.12. A number of points were raised calling for Ofgem to identify the benefits up front of considering anything other than the status quo. Related to this were concerns that moving away from the status quo could mean adding a time delay to the process, and that this could have cost implications for current and future projects.

1.13. On the first of these points, Ofgem committed to undertaking a cost-benefit exercise and to publish this with our next consultation document to obtain views from industry. On the timing point, Ofgem suggested that the status quo model did not seem to be working at present given that projects have not been delivered to date. As such, a review that considered alternative models could unlock potential projects – either by the introduction of a new scheme or by the potential threat of the introduction of a new scheme.

1.14. A point was made that the scope of the open letter was too narrow and that connecting up the islands was as much about securing their long-term future than it was about unlocking the potential of wind resource. Ofgem agreed that there were wider issues, including the potential development of marine technologies, but that the scope of this project was necessarily limited by our statutory duties. However, Ofgem did say that other agencies, including national and local Government, may play an important part in the project going forward, and would certainly need to play a role in wider strategic development of these communities.

1.15. A number of issues were raised around the TNUoS charging methodology, specifically that it represents a cross subsidy from north to south and as such should be reviewed as part of this project. Ofgem responded to this on consecutive three points – (i) that the methodology is set by NGET; (ii) that it reflects the costs that users impose on the transmission system; and (iii) given this, we have approved the current approach to charging as we consider it meets the relevant GBSO licence requirements.

#### **Scottish Hydro's perspective – Paul Neilson (PN)**

1.16. The SHETL slides have been published alongside this note. Given that they are detailed, only key points are noted in this memo.

1.17. PN set out that SHETL are currently putting in place investment plans for the Scottish islands and considers that it is best equipped to take this forward – and under the current framework. Irrespective of Ofgem's project, PN fleshed out in some detail the investments it was proposing for the Western Isles, Orkney and Shetland, including timelines to construction (the slides refer).

1.18. PN indicated that the option of competitive tendering suggested in Ofgem's open letter was somewhat a misnomer as SHETL already employed competitive tendering when letting its contracts for equipment and services, in accordance with EU law. As such, they were already eliciting the most competitive price available.

1.19. Further, PN questioned whether any other asset provider could compete effectively with the SHETL given the very low cost of capital it is allowed through the price control formula (i.e. 4.38% post tax). PN argued that it would be very doubtful that any company that owned and operated a single line could finance its activities for less than a portfolio-asset owning company. In the light of another company requiring a higher cost of capital, PN considered that for reasons of fairness across all transmission licensees, Ofgem should review the cost of capital it allowed at the last transmission price control review.

1.20. PN concluded by arguing that SHETL is already taking steps to address the needs of the Scottish island communities. He added that any changes to the regulatory system would add a time delay and that this may lead to additional costs and missed opportunities.

#### Discussion points

1.21. A question was raised as to the merits of "strategic" investment by a TO (i.e. investment for future as well as current projects), with the point being made that what SHETL is doing meets current needs but does not address future requirements.

1.22. SHETL responded on two fronts. Firstly, it argued that any speculative investment would need to be appropriately funded by Ofgem (and ultimately by customers) given that there are investment as well as risk costs of pursuing this approach. As such, he argued that meeting current needs, with some spare capacity, was the most efficient approach. However, secondly SHETL also added that a key feature of the HVDC technology it was looking to employ for the islands was that it was modular, meaning that it is relatively easy to add additional capacity incrementally as and when necessary.

#### **Developer perspective – Bill Grainger (BG), Lewis Wind Power (LWP)**

1.23. LWP outlined its reaction to Ofgem's open letter, giving a perspective from a developer. The slides have been published alongside this note, and given that they are detailed, only key points from them are noted in this memo.

1.24. BG was concerned about the transparency of TNUoS charging, citing that LWP had invested around £4m in its project on Lewis to date, but did not know what this key element of its costs would be going forward.

1.25. BG argued that given LWP was looking to invest over £500m, it wanted the opportunity to influence its cost base as much as possible. As such, it had not yet asked for a connection onto the mainland as it was assessing alternatives to avoid onshore constraints (such as Beuly-Denny).

1.26. LWP had a slight preference for a merchant or competitively tendered approach, but did not strongly favour any. It thought that there might be other approaches out there that could lead to a more efficient solution (but did not offer an alternative).

#### Discussion points

1.27. The only point of note was that one developer indicated that its TNUoS charges had been quoted at £114/kW.

#### **Developer perspective – David Thomson (DT), Viking Energy (VE)**

1.28. DT from Viking Energy provided a second perspective from a developer. Again, the slides have been published alongside this note and again only key points from them are noted in this memo.

1.29. DT set out that there was more to the project on Shetland than producing electricity – it had wider community benefits and the company set-up (partly community owned) would ensure that local people and businesses would benefit directly from a transmission link to the mainland.

1.30. DT set out that the existing onshore windfarm on Shetland (Burradale) had never had a capacity factor below 50%, which demonstrated the excellent potential of Shetland for further and more expansive developments.

1.31. DT set out that VT's main interest in the regulatory model chosen to bring forward transmission investment to the islands was the one that brought the investment soonest, citing the time value of money as key.

#### Discussion points

1.32. Given that the VE presentation covered much of the same ground as earlier presentations, there was little discussion of note that followed.

#### **Concluding remarks – Robert Hull**

1.33. RH thanked each of the presenters and remarked that the workshop had elicited a number of views on a range of different issues, and that these will be factored in to Ofgem's work going forward.

1.34. RH noted that a number of the presenters and some of the discussion points had raised doubts that the costs of connection would differ significantly if an alternative provider was found through a competition given that SHETL are required to tender for products and services in accordance with EU law. RH went on to comment that this might be true when comparing like with like, but did not take into consideration that a competition could drive efficiencies even further and lead to innovative solutions that at this stage had not even been thought about.

1.35. On a specific point, RH referred to SHETL's argument that it doubted any other company could put in place the infrastructure necessary to connect the islands at transmission at the cost of capital it is allowed under the price control formula (i.e. 4.38% post tax). RH pointed out that this was a weighted average of debt and equity, and that it would be feasible, for example, that a more highly geared investment (i.e. with greater proportion of debt-financing) would be able to compete with the incumbent on financing grounds. RH argued that this fitted in with Ofgem's innovation arguments – i.e. that innovation stretched beyond technical innovation into commercial arrangements as well as financing.

1.36. RH reassured those present that Ofgem had recognised the calls that this project could lead to further delays in investment and that Ofgem would work to minimise these at all times. RH indicated that one way of ensuring current plans are followed through was to ring-fence these and put in place transitional arrangements to deal with them separately from future developments (which may or may not be subject to a different regulatory regime).

1.37. Finally, RH thanked the attendees and commented that it has been a successful workshop, that Ofgem would look to hold more of these as the project moved forward, and asked those present to provide any feedback on the session direct to Ofgem.

## Annex 1: Attendees at the workshop

Name	Company/organisation
Ian Funnell	ABB Ltd (UK)
Peter Jones	ABB Ltd (UK)
Bill Grainger	Amec
Heidi Ijoma	Balfour Beatty Capital
Richard Leigh	Balfour Beatty Capital
Sean McLechlan	Balfour Beatty Capital
Phil Hicken	BERR
David Still	Clipper Windpower Europe
Dennis Gowland	Fairwind Statkraft Orkney Ltd
Morten Henriksen	Fairwind Statkraft Orkney Ltd
Elaine Hanton	Highlands and Islands Enterprise
Shona Croy	Orkney
Gareth Davies	Orkney Renewable Energy Forum
Colin Gibson	Private
Brian Smith	Scottish and Southern Energy
Malcolm Burns	Scottish and Southern Energy
Mike Barlow	Scottish and Southern Energy
Paul Neilson	Scottish and Southern Energy
John Ireland	Scottish Executive
Neal Rafferty	Scottish Executive
Colin Taylor	Scottish Power
Graeme Vincent	Scottish Power
Aaron Priest	Shetland Islands Council and the Viking Energy project
David Thomson	Shetland Islands Council and the Viking Energy project
Brendan Turvey	Scottish National Heritage
Jason Ormiston	S-Renewable
Kenny McInnes	The Highland Council
Derek McKim	Western Isles Council
Nigel Scott	Xero Energy Ltd
Robert Hull	Ofgem
Colin Green	Ofgem
Richard Clay	Ofgem
Mike Leonard	Ofgem
Chris Lock	Ofgem