

*The Lord Mogg, KCMG*  
*Chairman*



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*Promoting choice and  
value for all customers*

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*Dear Ed,*

### **Transmission Access Review – Progress Update**

In the summer, Ofgem and Department of Energy and Climate Change jointly published the Final Report from the Transmission Access Review. This report brought together the conclusions from a comprehensive assessment of the arrangements which allow generators to access the electricity transmission grid in Great Britain. The review, which spanned almost a year, involved a substantial commitment by industry, Government and Ofgem.

In the Final Report, Ofgem made a commitment to write to you before the end of 2008 to report on the progress being made towards implementing the required reforms. These reforms address both the immediate and longer-term challenges. They include: short-term measures which will allow more renewable generation to connect in the next two years; measures which will radically reform commercial arrangements by April 2010, to allow faster access by all generators; and the creation of new incentives to encourage a significant and timely investment in new transmission capacity, to deliver the 2020 targets.

I am pleased to report on progress. I conclude that a significant amount has been achieved in all three of the areas set out in the Final Report. However, there are still real risks associated with the industry change process to deliver a new enduring access regime. Nevertheless, I do not consider the industry process has yet reached the point at which it is necessary for you to take additional action. I suggest that we should jointly keep this situation under review. I shall write to you again with an update before the end of March 2009.

### **Background**

The Final Report from the Transmission Access Review set in train a range of work designed to reform the current arrangements through which generators, including renewable generators, are provided with access to the grid.

Since the publication of the Final Report, the Energy Act 2008 has received Royal Assent. The Act grants the Secretary of State the power to modify licences and associated documents to facilitate access to, or the efficient use of, a transmission system in Great Britain or offshore waters. These powers were included late in the Parliamentary process with the intent that they should be used if the industry process was not moving quickly enough. In addition to reporting on progress, I set out my views on whether it would be appropriate for you to exercise your powers under the Act at this point in time.

The Act also contains provisions which, once commenced, will modify the general duties of the Authority in carrying out its functions. In particular, those changes will mean that the Authority must accord equal weight to the need to contribute to the achievement of sustainable development, the need to have regard to the need to secure that all reasonable demands for electricity and gas are met; and the need to ensure that licensees are able to finance their regulated activities. The Act has also highlighted that the Authority's consideration of the interests of consumers includes future as well as existing consumers. The changes to our duties serve to underline our ongoing commitment to facilitate the achievement of sustainable development.

I set out below the key recommendations from the Final Report of the Transmission Access Review; progress to date; and my view of the key risks to the timely delivery of the necessary reform.

### **Key Recommendations from the Transmission Access Review**

The Final Report of the Transmission Access Review identified three areas of work necessary to allow generators easier access to the Grid:

- steps to create **funding and enhanced incentives** which will encourage the transmission companies to build the infrastructure required for 2020 in a timely way;
- the development of **enduring grid access arrangements** which will improve the use of the existing network and reduce the existing queue of generators waiting for connection; and
- **short term measures** to allow more renewable generation to connect in the next two years before the enduring regime can be developed and implemented.

### **Progress to date**

Work on **funding and enhance incentives** is being led by Ofgem:

- Ofgem has already allowed a 160 per cent increase in investment so that the companies will invest at least £4bn in the onshore electricity transmission grid between 2007 and 2012. We have also allowed investments of a further £560 million to enable work to start on investment including the upgrade of the line between Beaulieu, in the Highlands, to Denny, near Falkirk. Last year we signalled that we were willing to allow further investment of around £190 million to provide a connection between the Western Isles and mainland Scotland.
- We have invited the transmission companies to develop detailed investment plans that would deliver the transmission capacity required to meet the 2020 targets. As you know, Ofgem continues to work hard to ensure that access to the transmission system does not act as a barrier to renewable and other new generation.

These plans, which will be presented to the Energy Network Strategy Group on 18<sup>th</sup> February 2009, will provide a solid basis for future decisions on grid investments.

- This week, we will publish a consultation on the way in which we plan to adapt the regulatory framework to remove impediments to the transmission companies investing to meet the demands of the 2020 targets. This consultation sets out our view that we should move quickly to remove short-term blocks to investments. It also describes our current thinking and proposed next steps for the development of enhanced financial incentives for the transmission companies. These incentives will allow the transmission companies to predict future demand for transmission capacity and invest to deliver capacity when and where it is required. This should allow us to move away from the current situation where investment lags behind demand for new capacity giving rise to bottlenecks, high constraint costs and the queue for access. Following consultation, we will implement changes to the regulatory framework from April 2009.

The industry and National Grid are working hard to progress work on **enduring grid access arrangements**. The necessary radical reform requires changes to industry agreements; the way in which National Grid charges for the use of the grid - and to the commercial incentives on National Grid and the other transmission companies. The incentives will encourage the transmission companies to maximise the capacity available from their existing assets at all times, without creating excessive risk or cost. Work on the industry agreements has been packaged into six distinct proposals, all of which are well developed. We expect five of the proposals to be presented shortly to the Authority for its consideration. The sixth proposal is due to be presented in February/March 2009. We will consider the merits of these proposals and, following consultation with the industry and an impact assessment (both of which we are legally obliged to do), we expect to publish our final decisions in the summer of 2009. However, based on the information presently available, the industry proposals appear to address the range of issues that we identified in the Transmission Access Review, though we have concerns which are set out below.

Separately, we have had a number of high level meetings with National Grid to discuss the timetable for implementing the organisation and computer system changes required to support the new arrangements when they are agreed. We are confident that, once agreed, key reforms could be implemented in the period up to April 2010.

Work on **short term measures** is largely being led by the transmission companies, with Ofgem ensuring that they remain focused on this critical activity. Ofgem also have a role in granting permission, for an interim period, for the transmission companies to adopt lower grid standards, where appropriate, to facilitate the connection of generation. Through its work, National Grid has identified some scope to advance the connection dates of 450MW of renewable generation in Scotland, representing a 16% increase in the installed renewable capacity in Scotland. National Grid is also exploring possibilities to advance a further 1,600MW of renewable generation.

### **Key risks**

Whilst considerable progress has been made in all of the areas set out in the Final Report from the Transmission Access review, there are significant risks associated with the industry's work to define enduring grid access arrangements. In particular; I should note the following:

- There is a risk that the range of modifications that will be brought before the Authority will not be comprehensive. The industry has discussed a range of options for reform, some of which have not been pursued through the industry process. We will be in a position to express a view only when the industry process is further advanced but we are actively engaged in the process, attend all the key meetings, and provide views to try to reduce the risk of this outcome.
- We are also concerned that the industry may not be tackling grid access reform in a holistic way. The envisaged changes will touch on industry codes; charging; and on the incentives on the transmission system operator. We continue to discuss these issues with National Grid and the industry but there is still a risk that our concerns are not addressed.
- There remains a further risk of a delay to the completion of the industry's work.
- Finally, we have had longstanding concerns about the ability of the industry processes to tackle major policy reform. (As a consequence, we have initiated a review of the way in which changes to the industry arrangements are governed, although any changes that follow from this review will arrive too late to assist with the reform of grid access.) The problems associated with the current process may have increased the risk of a successful legal challenge which could come in one of two forms – either a challenge through the Competition Commission (if we decide to approve a proposal that was not supported by the majority of industry representatives), or by way of judicial review. Even an ultimately unsuccessful challenge could delay implementation of the new enduring arrangements.

Ignoring the impact of short-term or enduring transmission access reforms, National Grid is forecasting for 2009/10 that the costs of operating this system will be £1.2bn, almost double those in 2007/8. These costs are additional to the £1.3bn annual costs of funding new and existing transmission infrastructure. These costs will put further upward pressure on consumers' bills. Constraint costs are approximately £300m of these system operation costs; mostly incurred in Scotland. Allowing more renewable generation to connect in Scotland under the interim connect and manage arrangements, before the physical capacity of the system is increased, could see the cost of constraints increase significantly. We are therefore now in urgent discussions with National Grid to look at whether there are ways to manage or reduce these costs so that we can allow more renewable generators to connect in the next two years without the constraint costs – ultimately met by customers – rising significantly. But any changes are likely to be controversial and may be opposed, or challenged, by existing Scottish generators.

As I have said I shall report in three months. The scale of all of the risks described above will become more apparent in the New Year. I do not consider the industry process has yet reached the point at which it is necessary for you to exercise your powers under the Energy Act 2008.

I am happy to arrange for any further explanations you may require.

James Sweeney,  
