

The Rt Hon Ed Miliband MP
Secretary of State
Department of Energy and Climate
Change
3 Whitehall Place
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30 March 2009
Our ref: Im/mp/sc

Dear Ed

Transmission Access Review – Second Progress Update

In my letter to you dated 17th December 2008 I undertook to write again before the end of March.

In my letter I reported on the progress being made towards implementing reforms and concluded that a significant amount had been achieved in all of the work areas identified in the Final Report from the Transmission Access Review. In my view, the industry process had not reached a point where it was necessary for you to take additional action. Nonetheless I saw real risks associated with the industry change process.

I now conclude that, whilst those risks remain, the industry process does not at this stage require you to take additional action, but I suggest that we should continue to keep the situation under review. I shall provide a further update before the end of June 2009.

Background

The Final Report from the Transmission Access Review brought together the conclusions from a comprehensive review of the arrangements which allow generators to access the grid. The review spanned almost a year and has involved a substantial commitment by industry, government and Ofgem. The Final Report 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 high voltage electricity networks in Great Britain.

The Energy Act 2008 grants the Secretary of State the power to modify licences and associated documents to facilitate access to a transmission system, or the efficient use of a transmission system, in Great Britain or offshore waters.

Key Recommendations from the Transmission Access Review

The Final Report 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** to 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.

Work on **funding and enhanced incentives** is being led by Ofgem. Since December we have made significant progress towards ensuring that the regulatory framework does not impede important work to strengthen and enhance the high voltage network. More specifically:

- at our request, the transmission companies have estimated the transmission investments needed to support the delivery of the Government's renewable targets (recently published by DECC through the Energy Network Strategy Group, (the ENSG Report)).
- In December, we published a consultation on how we plan to make the regulatory framework more flexible to allow the transmission companies to invest ahead of need, proposing to move rapidly to remove the short-term blocks to investments and develop longer-term incentives over the remainder of this year.
- The ENSG report also identified the need for urgent pre-construction work for a number of transmission investments. With the transmission companies, we have developed changes to the regulatory regime that will allow the companies to proceed with the pre-construction work without delay. We plan to implement new licence conditions in support of this aim by 1 April 2009.

The industry, National Grid and Ofgem officials are continuing to work 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 way in which National Grid is incentivised.

Work on the **industry agreements** was originally packaged into six distinct proposals. In addition, the industry is now considering two new proposals subsequently raised by industry parties. We are currently assessing the merits of the proposals and we plan to publish an initial Impact Assessment consultation before the end of April. Based on current information these options appear to provide an appropriate range of alternative approaches on which to base our decisions; however, the process is not without risks.

We are discussing with National Grid the timetable for implementing the organisation and computer system changes needed to support any new arrangements. Our view remains that the reforms could start to be implemented from April 2010, although some of the more complex reforms may take longer.

Work on **short term measures** is largely being led by the transmission companies, though we ourselves are seeking to ensure that the companies remain focused on this critical activity. National Grid has identified scope to advance the connection dates of 450 mega watts of renewable generation in Scotland (equivalent to 16% of the installed renewable capacity). Our open letter of 19th March indicated that we were minded to grant derogations that, subject to consultation and for an interim period, would advance 450 mega watts of renewable generation identified by National Grid. The principles that apply to this “minded to” decision are likely to lead to the same conclusions in comparable situations. Thus, we expect the principles to apply whenever generators seek connection to the transmission or distribution systems but would otherwise be delayed by the need to reinforce the wider transmission system. If confirmed, that decision would remove the main impediment to connecting renewable generation to the transmission system for an interim period.

It must, however, be noted that National Grid’s work to advance the connection date of renewable generation is likely to impact adversely on the **cost of operating the high voltage system**, particularly in Scotland (forecast by National Grid at £1.1 billion in 2009 - almost double the level expected in 2008). This will put significant upward pressure on consumers’ bills and therefore we are seeking to reduce these costs in two ways.

First we have asked National Grid to conduct an urgent review to consider (and, if appropriate, consult on) whether urgent changes to the existing commercial and charging arrangements for access to the GB transmission system are necessary to reduce operating costs. National Grid has subsequently brought forward two urgent modifications to address perceived shortcomings in the current arrangements.

Second, we are concerned that the GB wholesale electricity sector is vulnerable to undue exploitation of market power. This vulnerability is likely to increase with the significant increase in new renewable generation connecting to the system. Such undue exploitation could potentially result in very high costs to consumers. There are difficulties in applying Competition Act 1998 (CA98) legislation in the context of electricity wholesale, where market power could be held by more than one party and is often intermittent in nature. For this and other reasons, we shall consult on other possible approaches that could address such market power issues. I suggest that we arrange a meeting to consider this issue further as we have touched on it several times in recent discussions.

Key risks

Whilst considerable progress has been made in all of the areas set out in the Final Report, significant risks remain in connection with the industry’s work to define enduring grid access arrangements. In particular:

- Two of the proposals for enduring access reform are still under industry consideration. Without these proposals the range of modifications for Authority consideration may not be comprehensive.
- There is a risk that completion of the industry process might be delayed.
- In any event, we have (longstanding) concerns about the ability of the industry processes themselves to tackle major policy reform. We are now reviewing the way in which such changes are governed and our initial proposals are likely in the summer. That review is critical to progressing reforms in strategic and public policy areas within

the industry codes arrangements. Support from Government for this project will be important given that many of the drivers for change to the industry arrangements are public policy issues including the environment. Any changes will, however, be too late to assist with the reform of grid access. There is then a risk that problems associated with the current process may have procedural flaws that increase the risk of a successful legal challenge.

I propose that we should (jointly) to keep this situation and its risks under review. The substantial progress achieved over the last few months and our current work mean that we have not yet have reached a point when you need to exercise your powers under the Energy Act 2008.

I shall give a further report in three months when I believe the situation will be much clearer. Please let me know if you or your office require any further information.

Yours sincerely

Lord Mogg

(seen and authorised for signature by Lord Mogg)