

AB170-09SEL

Paddy Tipping (Acting Chair)
Energy and Climate Change Committee
7 Millbank
London SW1P 3JA

26th June 2009

Dear Paddy

Energy and Climate Change Committee Inquiry: The Future of Britain's Electricity Networks.

Oral Evidence Session of 20th May 2009: Ofgem.

Response to Comments from the Association of Electricity Producers, the British Wind Energy Association and the Scottish Renewable Forum.

I refer to the letter dated 15th June 2009 which you received from three of the generator trade associations - specifically, the Association of Electricity Producers (AEP), the British Wind Energy Association (BWEA) and the Scottish Renewable Forum (SRF). I feel it necessary to respond to that letter because it contains a number of factual errors, accuses me personally of having misled the Committee, which I strongly refute, and seeks to point the finger of blame for recent failings at Ofgem (rather than acknowledging the way industry has prevented progress on important issues).

Let me first deal with the factual errors in the letter, before I make some important observations.

Factual errors

The trade associations make two claims: they say I misled the Committee about the willingness of the industry to consider change; and that I deliberately perpetrated a myth that the "fourth model" - embodied in the two Connection and Use of System Code, (CUSC) amendment proposals, CAP171 and CAP172 - is a "connect and manage" model, rather than an "auction model".

Willingness of the industry to consider change

The trade associations' claim that the CUSC Panel was right to prevent further development and discussion on the "fourth model" and suggest that no legal arguments were made at the time the Panel made this decision.

The trade associations argue that the CUSC Panel's decision was reasonable because the "fourth model" was virtually the same as one of the existing options which was already before the Authority for consideration and decision (CAP166 Working Group Alternative Amendment 3, WGAA3). In support of this position they draw attention to some statements made by National Grid which appear to imply that National Grid considered the "fourth model" to be virtually the same as CAP166 WGAA3.

But, it is factually inaccurate to suggest that National Grid considered the "fourth model" to be virtually the same as one of the existing options. The 30 March 2009 CUSC Panel minutes, which I attach to this letter, state (at paragraph 1859) "[National Grid] confirmed that in the view of the proposer the two Amendments [the "fourth model" and the existing option] were substantially different".

The trade associations also assert that there was a lack of legal argument made or implied by National Grid and Ofgem at the time the Panel made its decision. Again, I refute this assertion. I would make two points:

1. In advance of the CUSC Panel meeting of 3 April, Ofgem wrote to the chair of the CUSC Panel raising several concerns about the process adopted by the CUSC Panel at its meeting of 30 March 2009 (when the Panel considered the "Fourth Model" for the first time.) This letter made clear that it was important all viable options for reform were developed and consulted on, before being presented to the Authority for decision. The letter urged the CUSC Panel to act in a reasonable and transparent manner and outlined concerns that the Panel may have prematurely rejected a valid reform option. The letter also noted that the CUSC Panel's decision was difficult to reconcile with previous positions of the CUSC Panel and statements made by the relevant Industry Working Group (some members of which were also CUSC Panel members). In our view, these statements indicated that the "fourth model" was a substantively different proposal. The letter also outlined concerns regarding the level of transparency surrounding the CUSC Panel's decision. A copy of this letter is attached.
2. The minutes of the 3 April 2009 CUSC Panel meeting, which are also attached to this letter, record our view (at paragraph 1899) that "it is important that they [the Panel] discharge this role reasonably and in a transparent manner ... the Panel should not take lightly a decision to reject a proposal at the outset". We also stated that the rule which was used by the CUSC Panel to prevent further work on the "fourth model" was not there to allow the Panel to make premature decisions on the merits of an Amendment. Since Panel Members had identified the need for a significant amount of new or additional assessment, the rule could not apply.

The decision to prevent further work on the “fourth model” was not unanimous. National Grid and two other members of the CUSC Panel, including a ‘non industry affiliated’ Panel member, voted that the “fourth model” could and should be allowed to be taken forward along with the others. There was no consumer representative on the Panel at the time the vote was taken. The individuals who voted to prevent further work on the “fourth model” were all employees of incumbent generators or the trade association that represents them. Our claim that certain generators prevented debate and consultation on the “fourth model” is therefore perfectly valid.

It is also noteworthy that the rule used by the CUSC Panel to prevent further work on the “fourth model” has only been used on one previous occasion since the CUSC was brought into effect nearly eight years ago.

Is the “fourth model” an Auction model?

The second charge laid against me is that I deliberately perpetrated a myth that the “fourth model” is a “connect and manage” model, rather than an “auction model”.

In support of this, the trade associations refer to National Grid’s opinion that the “fourth model” is an auction model. Without wishing to appear didactic, I would rather refer to the authority of the Oxford English Dictionary: an auction is a “public sale in which each bidder offers an increase upon the price offered by the preceding”. The “fourth model” is not a auction in this traditional sense because it does not involve generators offering increased prices; indeed, it does not require generators to bid a price for access at all.

The “fourth model” is a form of “connect and manage” in any reasonable interpretation – everyone who wants access is guaranteed a connection. It guarantees generators the access that they request, in the same manner as the “connect and manage” model, regardless of the physical ability of the grid to cater for this demand.

Moreover, we had understood industry’s concern about auctions related to the fact that the total volume of capacity to be sold would be fixed. As a result, some generators might end up bidding very high prices to secure capacity, or not secure rights to access at all. The “fourth model” deals with both these issues and, in that sense also, is not an auction.

Other Observations

I would now like to make some general observations on the points made by the trade associations.

There is an implied suggestion that Ofgem acted unreasonably by preventing appropriate extensions to the work of the industry committees charged with developing the access reform proposals. There is also an implication that this resulted in inadequate analysis and consideration of the models. Without going into the detail, I would simply note that work on the proposals raised by National Grid in April 2008 was originally scheduled for completion in time for discussion at the July 2008 CUSC Panel meeting. In the event, Ofgem agreed to extensions which meant that work on the most complex proposal was not completed until March 2009; an extension of eight months.

Contrary to the views of the trade associations, I consider it entirely appropriate for us to raise concerns about the merits of the option which has attracted the greatest amount of industry support, namely the Alternative Connect and Manage approach. I explained in my letter to the CEOs, which I also attach for information, why I consider that it may be difficult for us to accept the Alternative Connect and Manage approach. This proposal may be illegal under the EU Directive due to the way it treats new and existing generators differently. But even if this isn't the case, it would potentially make the economics of new generation – and particularly renewable generation – relatively unviable. National Grid's initial analysis shows that charges would be high and volatile. In the North of Scotland a wind farm would face access charges of nearly £55/MWh compared with £6/MWh for a thermal plant and charges will vary year-on-year and would be volatile, depending on the pace of connection.

It is wrong for the trade associations to suggest that Lord Mogg's March letter is at variance with more recent statements from Ofgem. National Grid's analysis has only recently become available to us. It was not available at the time that Lord Mogg wrote to the Secretary of State. Moreover, Lord Mogg identified a number of risks associated with the industry process. One of these risks was that two new proposals for enduring access reform (including the "fourth model") were still under consideration. Without these new proposals Lord Mogg considered that the range of modifications submitted to the Authority for consideration might not have been comprehensive. In the event, this risk has become manifest - the industry has prevented further work on the "fourth model".

The electricity generation sector must play a major role in delivering the UK's ambitious emission reduction targets. It is regrettable that the industry appears to have failed at the first hurdle. There appears to be a lack of readiness to ensure that all viable alternatives to resolve grid access be examined and put before the Authority at the same time. This would have significantly increased the possibility of a solution that is fair to existing and new generators (both new renewable and other new low carbon generators) without exposing hard-pressed electricity customers to excessive and unnecessary costs. In my view, such a compromise is feasible - a solution that would ensure that the connection of substantial volumes of new, low carbon generation over the next few years is achievable without exposing customers to excessive and unnecessary costs. The failure of the industry to respond to this challenge is the reason that the Authority has now recommended that the Secretary of State should take on powers under the Energy Act 2008.

Yours sincerely

ALISTAIR BUCHANAN CBE
CHIEF EXECUTIVE

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Colleagues (to be published on the web)

David Porter O.B.E Chief Executive Association of Electricity Producers

Maria McCaffrey Chief Executive British Wind Energy Association

Jason Ormiston Chief Executive Scottish Renewable Forum

Tom Goldsmith, Clerk to the Energy and Climate Change Committee

David Green, Chief Executive UK Business Council for Sustainable Energy

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