

Transmission Access Review

Enhanced Transmission Investment Incentives: Update and Consultation on Further Measures (Ref 110/09)

Response by SP Transmission Limited

This response is from SP Transmission Limited as the regulated transmission business, which owns and maintains the electricity transmission network in south Scotland.

Since the December 2008 incentives consultation was published, it has become even more evident that reinforcing the GB transmission system as quickly as possible is fundamental to meeting the UK Government's renewable energy requirements. This has been our central message since the start of the Transmission Access Review.

We embarked on the investment incentives process back in April 2008 but so far we have not seen any proposal from Ofgem on incentive design. Indeed, the emphasis has now shifted from incentive design to ensuring that funding is in place from 2010/11 for the more urgent reinforcement projects. We would stress that if these projects are not to be delayed then it is important that Ofgem provides clarity on funding by early January 2010 at the latest.

Even taking a conservative view of the level of renewable generation connecting in Scotland there is still a clear need for the projects detailed in the March 2009 ENSG report. We therefore question why Ofgem have been so intent to move away from funding mechanisms that were built into the licence a relatively short time ago, or what the impact assessment is that supports the case to do so. For reinforcements for which the need case is obvious, we strongly recommend that Ofgem's focus should be on cost-efficient and timely delivery rather than user commitment. Given the urgency, Ofgem must therefore concentrate on providing a stable and enduring investment framework that can be implemented quickly. This can be achieved by making use of existing arrangements such as the deep revenue driver incentive developed for TPCR4 or by extending TIRG.

The attached appendix provides our answers to the specific questions raised by Ofgem.

SP Transmission Limited
6 October 2009

CHAPTER: Two

Question 1: Do respondents have any comments on the information provided on the projects nominated for funding consideration?

-

Question 2: Do respondents agree with our proposed approach for taking forward the assessment necessary for consideration of all requests for further funding during the current price control period, including SHETL's requests in relation to Knocknagael and the Shetland connection?

It is important that whatever approach is adopted allows the transmission companies to invest under a stable investment framework.

CHAPTER: Three

Question 1: Do respondents consider that we have appropriately summarised the views of respondents to our December consultation?

-

Question 2: Do respondents have any views on our proposed funding framework based on categorisation of projects in terms of risk profile and urgency for clarification of funding?

The current regulatory process for investment incentives has created the risk of more funding delay. Critically this could disincentivise companies from making the necessary investment.

For the projects in SP Transmission's area, the need case for the investment is clear. We agree that it is correct for Ofgem's consultants to validate our investment proposals but given the urgency to reinforce the GB transmission system we would again stress that it is essential to ensure that funding is in place to allow key reinforcement projects to proceed without delay. In order to limit the risk profile for the transmission company it is important that any funding arrangements are secure and stable over the duration of a project. It is difficult for a business to justify investment when project funding is provided on a short-term and uncertain basis.

Given the clear need for the ENSG reinforcements in our license area we continue to question why complex incentive arrangements are required. Ofgem should focus on measures that incentivise cost effective and timely delivery. There are incentive mechanisms in place that Ofgem could use such as the deep revenue driver incentive developed for TPCR4 or by extending TIRG.

Question 3: Do respondents agree that our work should focus on projects which are planned to commence construction within the current transmission price control?

We are disappointed at the lack of progress on investment incentives since work started with Ofgem back in 2008. Given the urgency to reinforce the GB transmission system to meet Government and European energy targets it is essential to ensure that funding is in place to allow key reinforcement projects to proceed without delay. As a minimum, stable funding must be provided for those projects that need to commence construction within the current price control period. If these projects are not to be delayed then it is important that Ofgem provides clarity on funding by early January 2010 at the latest.

Question 4: Do respondents have any views on the appropriate scope and form of funding for projects with different risks?

In order to limit the risk profile for the transmission company it is important that any funding arrangements are secure and stable. It is difficult for a business to fund its investment requirements when project funding is, for example, provided on a cost only basis from one year to the next.

Given that there is a clear need for our ENSG reinforcements, Ofgem should focus on arrangements which incentivise cost effective and timely delivery. We recommend that Ofgem make use of existing incentive mechanisms such as either the deep revenue driver incentive developed for TPCR4 or through extending TIRG.

Question 5: In terms of scope of funding, do respondents have any views on whether our funding consideration should include funding of pre-construction work in projects not due to commence construction within the current transmission price control? Do respondents have any views on the options for provision of such funding?

The only project for which we believe that we require pre-construction costs is the West Coast HVDC link. We are undertaking onshore works through the "advanced engineering" funding provided under TPCR4.

Our agreement on cost pass through for pre-construction funding for 2009/10 was based on this arrangement covering one year only. Given that the costs for the HVDC project for 2010/11 are significantly higher than 2009/10 we would prefer a secure and stable funding arrangement which is based on adding reasonably incurred investment to our transmission RAB, rather than cost pass through.

Question 6: Do respondents have any views on the appropriate “building blocks” for a funding mechanism and the principles which should be adopted in the development of funding mechanisms for the projects nominated for our consideration under TO incentives?

In terms of projects in our licensed area, incentives to invest ahead of user commitment are unnecessary. Ofgem's focus should be on measures to incentivise cost effective and timely delivery. As we have already commented, there are incentive mechanisms in place that Ofgem could use.

Use of Consultants

We realise that it is very important for Ofgem and DECC to have comfort that the GB investment plans are fit for purpose, cost-effective and deliverable in the timescales proposed. However the companies will be required to work with Ofgem's consultants over the coming months in duplicate with urgent work need to maintain progress. We are therefore concerned that this could divert resources and hinder progress.

We also have a concern over firming up on costs too early in the process. The ENSG reinforcements are complex technical projects that involve considerable parallel work around HVDC, series compensation and wide area monitoring systems. Much of the detailed design will come through the Development Agreements to be cut with the supplier community. The completion of the development work will lead to a competitive procurement process for the construction works and at the end of this procurement process we will then have a clearer view of costs, risks and market value. We believe that we should be tested on cost-efficient delivery at the construction stage. Any attempt to try to fix costs at an earlier stage increases the risk faced by transmission companies and may well lead to increased costs.

Question 7: Do respondents have any views on the interactions with the RPI-X@20 project or adoption of a competitive approach for the projects nominated by the TOs?

RPI-X@20

Ofgem requires to align any incentive design with the outputs of RPI-X@20 project. As there is a risk that this project may not complete in time for investment funding to be in place for 2011/12, it is therefore important for the right TO incentive framework to be in place prior to the start of TPCR5, irrespective of progress on the RPI-X@20 project.

Competition

Given the level of onshore and offshore network investment required to deliver 2020, all approaches to investment financing and timely delivery must be seriously considered. However, it is important to note that we are working with all the main suppliers in the industry already - indeed worldwide - and that for all of the transmission investment undertaken by the ScottishPower around 80% of the construction activity is outsourced to the market. We would argue that competition in the construction phase is already facilitated through our existing procurement

arrangements. Further, we have seen little evidence to suggest there is a huge appetite in the external market to take on cost and risk of design, construction and full asset ownership and question whether or not this would drive sensible economic development of the UK Transmission Grid going forward.

CHAPTER: Four

Question 1: Do respondents have any views on our proposed approach for taking forward our work on TO incentives further measures?

In our view Option 2 to "reducing the scope of funding under TO incentives" is the only viable option for making any progress. This option allows for the TOs to at least be funded for 2010/11 although this in itself is not sufficient.

In a climate where balance sheet strength is important to all and cash is key to that, it is very important that Ofgem reach a decision on 2010/11 funding no later than mid January prior to the 2010/11 charging year.

Question 2: Do respondents have any views on the potential adoption of an accelerated process for certain licence changes?

We are willing to support a fully consultative process for accelerated licence changes.

The Licence modification process is very important given that it takes time under the current process to assess and implement Licence changes e.g. for TIRG projects. However this probably reflects Ofgem's workload and we suggest that, given the importance of the network reinforcement projects, Ofgem should devote more resource to this activity.

Question 3: Do respondents have any views on the options for alignment with the outputs of the RPI-X@20 project?

Given that we are only now starting to see some working papers from the RPI-X@20 project, we are concerned that there is a risk that this project may not complete in time for investment funding to be in place for 2011/12. We therefore believe that it is important for a secure and stable TO incentive framework to be in place prior to the start of TPCR5, irrespective of progress on the RPI-X@20 project.