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Our Ref: AVT/JB/JT

Your Ref:

4 May 2011

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Dear Sirs

Submission to Ofgem on New Enduring Electricity User Commitment Arrangements

The Council is grateful for this opportunity to submit its views, in response to Ofgem's letter of 22 March 2011, on the proposal for new user commitment arrangements.

The Council agrees with the view, noted in that letter, that the user commitment issue is as big a hurdle as transmission charges to projects seeking a connection to the grid. Indeed for Orkney the two issues operate in tandem to present a linked pair of hurdles, since uncertainties about transmission charges make developers more reluctant to make a commitment involving liability to grid reinforcement costs.

There is a perceived element of discrimination in current user commitment requirements, in that large companies are more able to shoulder this kind of commitment than small companies. And in Orkney, in common with some other peripheral areas, many projects are relatively small, both because of planning and environmental constraints, and because a number of these projects are developed by small locally-owned companies. Such companies can experience difficulty raising capital for their own project, let alone taking on the liability, or a share of liability, for new transmission works. They are likely to find it difficult to compete on this basis with larger, better funded companies, and projects started by smaller local companies can end up in the control of larger, often international companies as a result.

High Level Principles

The Council therefore welcomes the review of connection arrangements, and the Ofgem statement, in its letter of 22 March 2011, that it is not convinced that current arrangements strike the right balance between new and existing network users, the network companies, and consumers. The Council understands the need to protect consumers from undue risks, but in considering the interests of future as well as current consumers, the risks to security of supply and to carbon-reduction goals need to be weighed against the risks of stranded assets. Current arrangements, in the Council's view, do present a barrier to entry for new generation, especially renewable generation, and hence a threat to the achievement of carbon reduction and renewable generation goals. The balance between the high level principles of protection of consumers and ease of entry for new generators does therefore need to be modified.

Currently in any case transmission charges represent a very small proportion of consumers' bills, and therefore the transfer of some risk from generators to consumers will represent a small potential burden for consumers for a much larger lightening of the potential burden on generators. In effect, consumers are more capable of taking on the risk than are new generators, and it is future consumers (who for the most part are also current consumers, or children of current consumers) who stand to lose most if investors are deterred from supporting new generation projects.

Pre-commissioning Risk

In any case new generators already make a substantial and escalating commitment to their own project, once they have obtained necessary consents, and have placed orders for turbines. The risk that their project will be terminated prior to completion therefore diminishes as the project progresses. This generic risk profile should be reflected in the extent of user commitment required over the period of the project.

In addition to the generic level of risk, the Council supports the view that user commitment requirement should reflect the specific risks associated with a specific project. In the case of renewables, developers will tend to be attracted to areas with the greatest renewable resources, such as Orkney with its advantageous wind regime, and its wave and tidal resources. In this situation, the risk of a stranded asset is very low, since the termination of one project is likely to see other projects coming forward to take advantage of additional planned network capacity. This is especially the case given that there are multiple actual and possible projects, rather than just one single project. The termination of a single project leaves others which may be capable of expansion, as well as new projects that will be attracted to make use of available capacity. The Council therefore believes that the risk of a stranded asset in the Orkney situation – and other analogous situations - is very low, and that any user commitment should reflect this fact.

Post-commissioning Risk

The same argument applies to the risk of termination by a post-commissioning renewable generator – and extension of post-commissioning commitment appears to be one of National Grid's principal concerns, as much as the reduction of pre-commissioning commitment, in its modification proposal CMP192. A renewable generator has a high capital cost but low running costs, compared with a thermal generator, since there are no on-going fuel costs. Once commissioned therefore there is no likelihood of termination of a renewable project until it reaches the end of the economic life of the generating assets, and even then it is likely that such assets would be replaced. In this situation the concern with post-commissioning risks could lead to the imposition of additional, unnecessary, burdens on renewable generators.

CUSC Modification Proposal CMP 192

This proposal is frankly disappointing. Whilst accepting that the document is high level, it lacks clarity and appears to be excessively concerned with extending user commitment to the post-commissioning stage. Such detailed information as the Council has been able to obtain indicates that National Grid is also looking to re-instate user commitment for wider works. The Council understands that whilst pre-commissioning security requirements may be reduced, liability will remain, and this will not be helpful for smaller companies.

It would appear on this basis that the whole direction of the proposal is wrong, and will complicate and extend the user commitment issue, instead of simplifying and lightening the burden.

There must be some dubiety on a *priori* grounds as to whether the normal industry processes for modifying codes are going to be adequate, when a radical change of direction is concerned, such as is now the case with the high level principles set out by Ofgem to deliver a sustainable energy network. Whilst intending no disrespect to the individuals and companies involved in the CUSC working group, to expect agreement in such a group in respect of a major change in the regulatory framework, to reflect a major shift in national priorities, is perhaps asking too much. The information on the direction of the proposal does nothing to alleviate the Council's scepticism about this procedure. Firmer direction is needed, and that can only come from Ofgem.

The Council believes that both the pre- and post-commissioning risks, in respect of renewable energy projects in the peripheral areas, are slight. It believes that a wider range of possible options for dealing with this risk needs to be considered, rather than modification of the existing cumbersome mechanism being the only option. For example, no consideration appears to have been given to treating the user commitment issue simply as an insurance matter, with the risks of termination being weighed up by a third party, and then dealt with on a straightforward insurance basis.

Appropriate triggers for a Significant Code Review by Ofgem

In the light of its concerns about the effectiveness of existing procedures, both on a *priori* grounds and as a result of the CMP192 proposal and subsequent details, the Council believes that it is likely that Ofgem will have to initiate the procedure for a Significant Code Review, and indeed that such a review will be required, in order to achieve the radical change that is required. It would appear from the tone of Ofgem's letter that Ofgem itself has some concern about an appropriate outcome, consistent with the high-level principles.

In practical terms, some reduction of the burden on generators of underwriting user commitment has to emerge from this process, and in the Council's view this reduction should be substantial, in order to enable renewable projects to access the network. It should reflect the level of risk arising from specific projects. The new regime should be simpler for generators, not more complicated. There is a strong case that a wider range of options for user commitment, rather than just one proposal, should be considered. In deciding whether to trigger an SCR, Ofgem will have to make a judgement about the likelihood of these points being met by the existing CUSC modification procedure. In the Council's view such a decision cannot be long delayed.

Yours faithfully



Albert V Tait
Chief Executive