HIE
Highlands and Islands Enterprise
Iomairt na Gàidhealtachd's nan Eilean

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Dear Ynon

Highlands and Islands Enterprise (HIE) is the Scottish Government's agency responsible for economic and community development across the northern half of Scotland and the islands.

Renewable energy resources in HIE's area constitute the greatest concentration of potentially exploitable renewable energy resources in the UK. Indeed, the area has a long association with the production of renewable electricity given the existence of much of Scotland's large scale hydro which has contributed to the UK's electricity generation for a number of decades. The region is home to some of Europe's strongest sustained wind regimes along with some of the world's best wave and tidal regimes and is well placed to contribute to UK and European carbon reduction and renewable electricity generation targets *if* key regulatory barriers can be effectively addressed to facilitate deployment of renewable technologies. The Highlands and Islands are also well placed to contribute to the regulatory objective of security of supply by facilitating the deployment of a geographically dispersed, range of technologies which also makes economic sense in a wider context.

HIE along with its local partners: the democratically elected local authorities covering the north of Scotland and the islands: Shetland Islands Council, Orkney Islands Council, Comhairle nan Eilean Siar, Highland Council, Argyll & Bute Council and Moray Council make representations to key participants on behalf of industry to influence the way in which grid construction is triggered, underwritten then accessed and charged for in the region. We are working closely with Scottish Government in relation to a wide range of regulatory issues and are supporting its efforts to challenge barriers currently blocking renewables development across Scotland. . Included in our efforts have been responses to many industry consultations where experience has taught us that our joint response on behalf of seven partners tends to be counted as one. Given that this consultation this has potentially far reaching impacts for the Highlands and Islands, we hope that it will be given due recognition in terms of both weighting and 'headcount'.

Projects connecting at Extra-High-Voltage (EHV), effectively 33kV, make up a good proportion of renewable projects in HIE's area. These generators have been faced with up-front reinforcement costs, significant underwriting for transmission reinforcements, ongoing uncertainty on liability for transmission charges, grid code compliance issues (sometimes conflicting with distribution codes and obligations) and, for post-2005 generators, GDUoS.

To-date, of these challenges, GDUoS has been a relatively low profile issue. Whilst methodologies can be difficult to understand; tariffs are reasonably straightforward to

obtain and simple to apply. Post-2005 generators still pay a significant proportion of their costs through up-front capital contributions. The EDCM methodology does not change this. Rather, the EDCM methodology makes the GDUoS element higher in most cases and in all cases more complex, variable and unpredictable. Furthermore, unless a generator is already connected, it is proving difficult to obtain any indication of its tariff – this includes for generators connecting in 2012-13.

Overall we feel that Ofgem and the DNOs have been focused on the detail of what Ofgem itself describes as a "*highly complex methodology*" and has overlooked some more fundamental aspects of the methodology. Furthermore we are very disappointed that Ofgem has failed to assess the implications of data confidentiality which seem to preclude publishing tariffs and issuing the EDCM model to customers. We elaborate on these and other issues below.

Please note that HIE's response is focused on generation tariffs.

Cost signals

The core rationale for the new methodology is that users can respond to cost signals given by the methodology. At an ENA workshop earlier this year, users pointed out to Ofgem and the DNOs that there are no published tariffs, and hence no cost signals to which to respond. Whilst we acknowledge that this is due to unforeseen confidentiality issues, completely undermines the cost signal.

The DNOs acknowledged that some tariff mapping would be required in order to effect a meaningful cost signal. It is astonishing that Ofgem's consultation does not deal with this issue.

Recommendation 1: Ofgem should consider the impact of there being no published tariffs or tariff mapping, which effectively removes any pre-commissioning locational signal.

Ofgem also says that it wants to promote "*efficient use of the existing infrastructure*" by encouraging users to locate where there is spare capacity. We have serious reservations about whether the methodology will achieve this, because of its forward-looking nature. A generator that uses up spare capacity will be encouraged to do so by the low capital reinforcement charges. However, the EDCM methodology will, as we understand, signal the need for future reinforcement as soon as that generator connects, and return a high GDUoS charge, in so doing discouraging the use of spare capacity.

We struggle to follow Ofgem's logic in this approach. It may be appropriate for demand that shows incremental growth year-on-year, but it doesn't make sense for generators whose major decisions are all made up to commissioning, not afterwards.

Recommendation 2: Ofgem should consider whether the signals for generation are appropriate, and whether they align with the capital connection cost signals.

HIE is also concerned that the EDCM methodology double-signals the cost of shared reinforcements paid for as a customer contribution, the value of which is then incorporated into the EDCM methodology and used to allocate further costs to the same generator. We feel it is wrong to have overlap of the connection charging boundary and the Use of System charging boundary, and that this risks challenge where generators feel they are being signalled the cost of the same asset twice.

Recommendation 3: Ofgem should review the overlap of charging boundaries between connection and use of system.

Managing generator's charges

Data confidentiality issues have precluded the DNO's issuing the EDCM model to users. This means that options analysis for site location, capacity and output will all need to be modelled by the DNO for all prospective projects. The same applies for connected projects wishing to mitigate charges through flexing what they can – perhaps registered capacity and output.

However in the impact assessment Ofgem states that the new methodology will have "*small impacts*" on DNOs, "*for example in running the power flow model each year that produces the notional asset values.*" This is a very significant underestimate of the impact the new methodology will have on DNOs resources in supporting customers' needs.

Recommendation 4: Ofgem should re-evaluate the impact of the new methodology on DNOs and consider how to ensure all aspects are embraced positively.

HIE also shares Ofgem's concern about whether Generation and Demand Side Management agreements will be at the discretion of the DNO. A useful option for intermittent generation will be to have an export capacity lower than its nameplate capacity. HIE would also like to see options for groups of generators or generation and demand to collectively manage use of the network and see reduced charges as a result. The methodology should not prescribe when *and where generation, especially intermittent generation, has a network benefit.*

Recommendation 5: Ofgem should mandate the DNOs to be flexible with DSM and GSM agreements, and to make them available to all customers and customer groups.

Finally, generators may have grid code or DNO-related obligations which limit their operational flexibility. Where generators are providing a service of this nature, this should be reflected either in remuneration for the service, and / or in relief of network charges.

Recommendation 6: Ofgem should ask DNOs to consider GDUoS tariff mitigation where generators have technical and operation obligations to the DNO or National Grid.

Project TransmiT

Ofgem says in its consultation that Project TransmiT "*does not necessarily have implications for distribution charging due to the different nature of the networks.*" HIE agrees that the networks are different in many respects, but notes with some concern the ongoing and very damaging uncertainty caused by the debate on transmission charging for distributed generators. This debate was premised on National Grid and Ofgem's resolute insistence that distributed generation see the same cost signals as transmission-connected generators despite differences between the networks. In addition TransmiT may result in changes to transmission charges for demand users (Triads) which would have a major earnings impact on many distributed generators regardless of whether transmission generation charges are applied as well.

Ofgem's approval of EDCM could even prejudice the outcome of Project TransmiT, if cost signals between transmission and distribution are to be consistent. We would

prefer this to be tackled in an open and transparent manner. It would be damaging to approve EDCM only to then launch a Significant Code Review (SCR) in light of implications from Project TransmiT.

Recommendation 7: Ofgem should address the issues with Project TransmiT openly and transparently, and consider delaying approval subject to findings from Project TransmiT.

Predictability

HIE agrees with Ofgem when it states that "*beyond the one off change in charge, the ongoing stability and predictability of charges is important to customers, as it helps to reduce risk.*" This is a key point for generators in our area. HIE notes that sources of volatility are largely outside of the control of generators. The DNOs have not addressed these "*exogenous*" sources of volatility because they themselves cannot predict them. The DNOs have also done nothing to mitigate this volatility for generators – the caps and collars on network use factors only apply to demand customers.

This is a major down side of the EDCM methodology. HIE notes that unpredictability and a lack of ability to control costs was the reason that Ofgem rejected Locational BSUoS proposals.

Recommendation 8: Ofgem should require the DNOs to mitigate volatility in generator charges before EDCM is implemented, or reject the proposals.

Transparency

As noted above the methodology is currently non-transparent (i.e. the model and tariffs cannot be published), and "*highly complex*" (which contributes to non-transparency). There is a real danger therefore that competition is hindered by virtue of the fact that only the DNOs can understand and model tariffs.

Ofgem also makes the assumption that the commonality of some aspects of the modelling across DNOs will increase transparency and accessibility of the model. HIE is not convinced of this. The current GDUoS tariffs also have common aspects across the DNOs. Existing tariffs can be opaque, ususally where DNOs apply a site-specific tariff. The Scottish DNOs do not currently apply these site-specific elements, or they are contained within a stated range.

HIE notes that the new EDCM tariffs also have fixed elements that are outside of the EDCM power flow modelling. We also note that the proportion of these fixed costs is very high in both Scottish DNO areas. These are attributed in Ofgem's consultation to O&M and network rates on sole-use assets. We would like a clearer definition of what these assets constitute, and when they will be incorporated into a generator's final tariff – i.e. before or after a connection agreement is concluded. It would seem however that the proportion of site-specific elements not published in tariff schedules, and potentially remaining unknown until connection is well progressed, has increased in Scotland. We would therefore seriously question whether commonality has brought the benefits stated in the consultation.

Recommendation 9: Ofgem's impact assessment should be re-worked to consider a more realistic comparison between the current GDUoS charges and the EDCM. This should include the EDCM's non-transparency and the high proportion of fixed costs in Scotland.

Consultation questions
HIE has responded here to some other detailed issues not covered above, and that are raised in consultation questions.

Question 2.1: What are your views on the key issues with the methodology we have highlighted? Are there any other issues or concerns with the methodology as a whole that we should consider?

We have highlighted some key issues above.

Question 2.2: Should we approve the methodology, do you agree with our proposal to implement it in full from 1 April 2012? If not, why is phasing-in charges or delaying implementation appropriate?

Our concerns are such that we feel, at the very least, that introduction should be delayed for resolution of some fundamental issues. We feel the non-transparency and predictability issues are serious enough to consider rejection on anti-competitive grounds.

We do not represent individual generators and so cannot comment on phasing or derogation to mitigate tariff shocks. However in general we support measures which preserve the conditions under which an investment was made, and support the electricity trade associations' joint letter on pre-2005 generation.

Question 4.1: Do you agree with our proposal to modify the generation revenue target in order to avoid double charging for operations and maintenance costs on sole use assets? This issue aside, do you agree with our view that the approach to calculating a generation revenue target is reasonable?

We agree that double charging should be avoided and also like to point out that most generators pay Demand DUoS for imports - typically availability and reactive power charges. This is an additional double charge as the same assets are used for import and export and both are charged. Although on generation-only sites this is only a minor double charge, for demand customers with generation this could be a very significant double charge and appears to discriminate against mixed use customers (i.e. with imports and exports). This would be a particular, even discriminatory , issue for storage providers.

Question 4.2: Do you agree with our assessment that the approach to scaling is reasonable?

It is difficult to answer this question and more explanation of the how the complex revenue recovery target is arrived at would be required before we could assess whether the approach to scaling is reasonable. This is representative of a number of elements in the proposed methodolology.

Question 4.3: Do you think it is appropriate for only units exported by nonintermittent generators during the super-red time band to be eligible for credits?

HIE feels this needs more work to accurately reflect the real benefits. This may be a good candidate for the future governance process and / or a condition on the DNOs.

Question 4.4: Do you agree with our proposal that intermittent DG should be eligible for credits as they are deemed to provide network benefits under ER P2/6? If they do

become eligible for credits, should the credits only relate to units exported during the super-red time band or is a single credit rate to all units exported more appropriate?

Again we would need to spend more time looking at the evidence, but in general we feel credits should be aligned to real benefits, and be payable to groups of generators and /or generation / demand sites.

Question 4.6: Are there any other generation specific issues that you think we should consider as part of our decision?

See comments at the start of this response.

Comments on the impact assessment
We have made nine recommendations to improve the impact assessment. In general we feel it is descriptive of the proposals with some assumptions on the benefits it will bring which do not appear to be evidence-based. There is a cursory assessment of the impact on generator revenues, but Ofgem provides no information on assumed income per MWh, hence this is difficult to comment on.

In HIE's view and in line with recommendations from industry; the direction of travel for transmission charges through Project TransmiT is a simpler, more predictable, less volatile, transparent methodology to facilitate a timely move to a low carbon energy sector. It would appear that for many of the principles just mentioned, the opposite is true of the proposed distribution charging methodology. In a market place where project developers are typically smaller and potentially less well placed to deal with complexity than transmission dependent operators; Ofgem's logic in proposing to introduce a highly complex methodology is apparently at odds with the wider electricity market and charging reviews.

I hope you find these comments useful and look forward to engaging fully and positively with the ongoing EDCM process. If you would like to discuss or require clarification on any of the issues raised in this consultation response, please don't hesitate to contact me.

Yours sincerely,

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In partnership with:
Shetland Islands Council
Orkney Islands Council
Comhairle nan Eilean Siar
Highland Council
Argyll & Bute Council
Moray Council