



Highlands and Islands Enterprise
to mairt na Gàidheallachd's nan Eilean

europeanwholesale@ofgem.gov.uk
cc: martin.crouch@ofgem.gov.uk

Tuesday 22nd May 2012

Dear Sir/Madam

**Highlands and Islands Partnership Response to Ofgem Open Letter:
Implementing the European Electricity Target Model in Great Britain**

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

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 and Argyll & Bute Council have, for a number of years, been making representations to key participants on behalf of industry to influence the way in which renewables are incentivised and 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.

Renewable energy resources in the Highlands and Islands of Scotland 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, producing the most cost-efficient power in the country. This would not have happened without political and monetary support and commitment for its (then) ambitious construction programme.

The region is also 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* a favourable policy environment can be developed/maintained and 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 and our local authority partners welcome the opportunity to respond to Ofgem's open letter on the European Target Model which is helpful in outlining Ofgem's thinking on UK implementation. The 6th of April workshop was also very helpful in gaining a wider perspective from the industry here and elsewhere in Europe.

HIE's perspective, as you may know, is to facilitate the best use of renewable resources in the north and west of Scotland and the islands. Interconnections serve an obvious and central role in realising this ambition through access to new markets for power and balancing services. In so far as developments from Europe facilitate exploitation of these opportunities, HIE is supportive.

We feel that the apparent focus of the European Target Model on day-ahead markets is not particularly relevant to the integration of intermittent and green energy. Intra-day markets and collaboration between system operators on balancing actions we feel are much more relevant. We are also concerned that any move towards market splitting would cut Scotland off from its existing markets rather than facilitate access to new markets. We elaborate on these points below.

The European proposals

Whilst Ofgem's open letter talks about intra-day trading and integration of balancing actions, the main focus for the European Target Model appears too concerned with a day-ahead market to facilitate cross-border trade.

Wind energy at the day-ahead stage cannot predict its output accurately, especially if the requirement is for accuracy in half hour blocks – as with any weather forecast, the chance that it will be windy the next day is easier to predict than the exact timing. Furthermore, cross-border trades of green energy are likely to be limited until such time as green credits are tradable across borders. For these reasons we are inclined to think that a day-ahead market focused on cross-border trade is not particularly relevant or useful for intermittent and / or green energy integration and trade.

HIE also doubts whether a voluntary, day-ahead market will be of any value to System Operators when balancing the system. National Grid already has a working group looking at how to deal with accuracy of notifications submitted under the grid code, with solutions around improving accuracy through shorter notification timescales.

For these reasons we feel the Target Model – and specifically a focus on a day-ahead market – will not facilitate integration of wind energy in the north of Scotland (although it probably won't hinder it either). We feel that more work is required in developing intra-day markets and cross-border balancing markets in which the System Operator has confidence.

Ofgem's "holistic" approach

In addition to implementing the letter of the European Target Model (i.e. a common algorithm to calculate day-ahead prices for a voluntary market), Ofgem is suggesting that it might go much further under a more "holistic" approach. One suggestion is that it can be used as a vehicle for market splitting in order to manage within-GB congestion, which we understand to mean Locational Marginal Pricing (LMP).

Whilst the European Target Model might be expected to cause minimal disruption to market participants, with many not noticing any change at all, LMP would likely have major impacts for most players. In fact this is the reason that Ofgem chose not to consider it as part of Project TransmiT. We feel there is a danger of over-playing the European Target Model with a view to justifying LMP, and we would strongly caution against this.

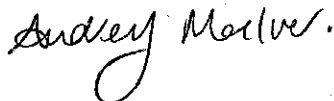
As you may know HIE would not be supportive of LMP if it added to the already high costs of accessing the grid in the north of Scotland. Furthermore, unless long-term

access rights were granted by virtue of paying existing access charges (TNUoS), confidence in the market would be severely damaged and investments compromised.

We would be more supportive of measures, outlined above, around promoting cross border balancing and intra-day trades. By their nature these would promote additional opportunities to integrate renewable energy. By contrast the perception of LMP is that it would limit existing routes to market well before alternative routes were available.

I hope you find these comments useful and would be pleased to discuss any aspect of our response with you.

Yours faithfully,



Audrey MacIver
Joint Head of Energy
Highlands and Islands Enterprise

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