

Beverly Grubb
Scottish & Southern Electricity
Networks
Inveralmond House
200 Dunkeld Road
Perth
PH1 3AQ

Email: connections@ofgem.gov.uk

Date: 6 September 2019

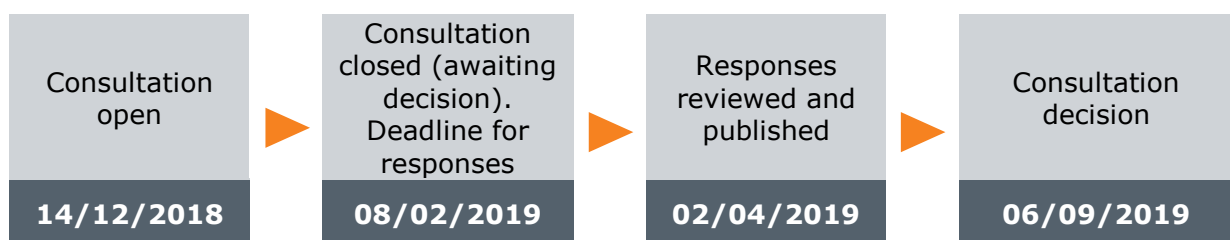
Dear Beverly,

Authority decision on SSEN's derogation request for Alternative Approach on Orkney

In December 2018, we consulted on a derogation for Scottish & Southern Electricity Network (SSEN)¹. The derogation would allow SSEN to trial their Alternative Approach (AA) with Orkney connections customers. The AA was developed by SSEN to provide a solution to facilitate transmission reinforcement on Orkney – as the network is operating at full capacity.

SSEN explained that transmission reinforcement has been difficult to progress because of the fixed connection queue, misaligned timelines for transmission investment and developers' project development and the liabilities and securities associated with transmission works.

Our decision making process



In line with our derogation guidance, we assess each derogation request individually on its merits in terms of the likely effect on the following items:

- Consumers;
- Competition;
- Sustainable development;
- Health and safety and the associated risk management measures; and
- Other parties affected by the non-compliance, including the ability of the relevant system operator or DNO to operate its system.

¹

https://www.ofgem.gov.uk/system/files/docs/2018/12/ofgem_consultation_on_ssen_derogation_request_for_orkney_alternative_approach.pdf

We have now considered all 11 responses to our consultation on our minded-to view on this derogation, and taken these into account in reaching our final decision. This is explained below.

The Ready to Connect process: Part 1

Part 1 of the AA derogation request is to implement a trial of the proposed Ready to Connect process. This trial would implement a revised approach to queue management, moving away from a process where connections are granted purely on the basis of the order in which parties have requested a connection. This part of the derogation would allow SSEN to move connections customers up and down the queue based on progress against their delivery plan and set milestones. A full explanation of the Ready to Connect process and the specific derogation requests SSEN made can be found in our minded-to consultation document².

In our minded-to view we explained that we are minded to approve Part 1 of the AA and the associated derogation requests and why.

10 respondents supported our Minded-to view. The Electricity System Operator (ESO) largely supported our view – but expressed some concerns which we have covered below.

Concerns raised

Whilst broadly agreeing with most of our minded-to view, the ESO raised concerns specifically on allowing customers to unfix their liability under securities arrangements³ as part of the ready to connect proposal. NGENSO argue that this could give a competitive advantage to connections customers in Orkney – as other connections customers outside of Orkney aren't able to unfix their liabilities and securities.

The ESO also told us that their own analysis shows that current costs and sharing factors *could* result in higher overall liabilities if currently contracted Users on Orkney are permitted to unfix their liabilities and that they *could* also result in lower overall liabilities. This means that there could be scenarios where the ESO is over-recovering and scenarios where the ESO is under-recovering – when compared to the status quo. However, the ESO stressed that this was extremely unlikely and based on a 'snap shot' of current Users contracted on Orkney. Due to the confidential nature of the analysis – we are not able to share full details.

The ESO has also told us that it could be argued that there could be a *possible* breach of their Licence as well as their CUSC obligations – if they were to facilitate Part 1 of the AA.

Our view

Table 1 provides a summary of our view on Part 1 of the derogation request. This builds on the assessment in our consultation document, updated in light of our considerations of consultation responses. We discuss our thoughts on respondents' key concerns further below.

²

https://www.ofgem.gov.uk/system/files/docs/2018/12/ofgem_consultation_on_ssen_derogation_request_for_orkney_alternative_approach.pdf

³ Currently, CUSC states that once a User has elected for the Fixed cancellation charge, Pre-Trigger amount, Attributable Works Amount and Cancellation Charge Profile to be fixed as that set in the Notification of Fixed Cancellation Charge the user cannot revert to the Actual Attributable works Cancellation Charge. This derogation would change that and Users would be able to revisit this choice

Table 1: summary of our view on Part 1 of the Alternative Approach proposal

Consideration	Our view
Consumers	<p>We still consider that the proposed queue approach provides a positive impact on connection customers, by helping them to connect more quickly if they are ready to. By voluntarily signing up to the process, we believe that the connection customers will understand the risks and potential benefits of moving up and down the queue. This approach should also make more efficient use of existing capacity, which should reduce the risk of stranded assets – and the potential associated cost to wider consumers. It could also bring some sustainable development benefits as discussed below.</p> <p>Whilst the ESO has raised some concerns on the potential of under-recovering – we do not think this risk is material. We expanded further below.</p>
Competition	<p>The milestones and timescales proposed will be standard across all affected connection customers. SSEN has consulted on these measures and took stakeholder feedback into account when setting out the proposed framework. Provided that the trial is developed in a fair, transparent and consistent way, we still do not consider the proposal to have any impact on competition. The approach is a trial and the derogation is for a specific group of customers, for a limited time. We do not think the queue management approach facilitates a competitive advantage to customers in the trial – as each will have a fair opportunity to develop their projects.</p>
Sustainable development	<p>We still think the proposals could have a potentially positive impact on sustainable development as they may increase the likelihood of renewable generation development and connection on Orkney.</p>
Health and safety and the associated risk management measures	<p>We do not think there are any Health and Safety and associated risks with the queue management approach proposed.</p>
Other parties affected by the non-compliance, including the ability of the relevant system operator or DNO to operate its system	<p>The proposed queue management process conflicts with National Grid’s interactivity process, and a specific aspect of the derogation (Section 6.10.4 of the CUSC, detailed in Section 3) ensures that the ready to connect proposal is used to allocate capacity on Orkney during the trial, as a pre-cursor to the interactivity process. SSEN has proposed that interactivity and a requirement to notify customers, should only be applied in exceptional circumstances under the trial. For example, where two (or more) customers with the same connection date (e.g. 2022) accept connection offers on the same day and there is insufficient remaining capacity in Phase 1 (or Phase 2) to meet both customers’ requirements. In this instance, the interactivity arrangements set out above would apply and the party who is first to accept the Bilateral Connection Agreement (BCA) from NGET (ESO) would take priority in the connection queue.</p> <p>We have elaborated further on possible non-compliance issues raised by the ESO below.</p>

With regards to the potential for wider consumers facing higher costs due allowing connecting customers to unfix their security/liability position (ESO under-recovers), we consider that the analysis conducted by the ESO is not definitive in pinpointing a material risk to consumers. Even if we did consider their analysis as conclusive, the likelihood of this happening is extremely low. The ESO also recognises this and confirms that the risk is extremely low. We must balance this analysis with the overall benefits of running Part 1 of the AA – and we believe the benefits outweigh this small risk.

We have also considered the risk that the ability for connecting customers to unfix could lead them to having higher securities/liabilities (ESO over-recovers). Our Minded-to view stressed that the trial needed to be implemented in a clear, fair and transparent way. SSEN consulted connections stakeholders throughout the development of the AA and Orkney connections customers can sign up on a voluntary basis. We would expect these customers to ensure they conduct their normal due diligence under the new arrangements.

We have considered competition again in light of National Grid ESO's comments – and we do not agree that this part of the derogation request would have an impact on competition through distortion.

Part 1 of the AA is a trial and the derogation is only applicable to a specific group of customers for a prescribed and limited time. Whilst we understand that other connection customers across GB will not be able to unfix their securities and liabilities – we must stress that the specific connections customers on Orkney will be allowed to unfix only because they made their initial decisions as part of a different connections regime which is being amended to run the AA. As such, because they're joining a trial with new rules, terms and conditions – it wouldn't be fair to those participating customers to not be able to re-evaluate a choice they would've made some time ago and under different rules and circumstances.

Further to this, we believe the learning from Part 1 of the AA will provide valuable input into what is a very complicated and contentious area; securities and liabilities in queue management – adding to the body of work that is coming out of the ENA Open Networks project⁴

We recognise the ESO's has voiced concerns surrounding a *possible* breach to their Licence and CUSC obligations by facilitating Part 1 of the AA and we have engaged further with the ESO on these concerns.

Our Decision

Having taken into account consultation responses, our Decision is to approve Part 1 of the AA. We would like to make it clear that we approve Part 1 and are allowing the one-off unfixing of securities and liabilities only in the context of this trial in Orkney. Furthermore, this decision does not constitute a wider approval of allowing ordinary connection customers to unfix their liabilities.

We believe that the proposed ready to connect process is likely to provide an overall benefit for connections customers and does not raise any significant competition concerns. We also think the trial will be useful learning for the continued work on queue management being done through the ENA Open Networks project.

⁴ Specifically Work Stream 2 has been considering queue management and are consulting on their findings here: <http://www.energynetworks.org/assets/files/ONP-WS2-Interactivity%20and%20Queue%20Management%20Consultation-PUBLISHED.pdf>

Temporary adjustment to securities and liabilities: Part 2

Part 2 of the derogation request would temporarily adjust securities currently required by developers by removing the liabilities related to the subsea cable, for a period. There is a significant cost associated with the 53km subsea cable element of reinforcement that would be triggered by connecting Users in Orkney (because of the current User Commitment arrangements).

The full process is detailed in our minded-to consultation document⁵. In our minded-to view we explained that we are minded to reject Part 2 of the AA and the associated derogation request.

SSEN, as well as various Orkney connections stakeholders have expressed concerns about our minded to position, while the ESO and Scottish Power Energy Networks supported our position.

Concerns raised

SSEN have raised concerns about the current security and liability arrangements. SSEN argue that the use of the Main Interconnected Transmission System (MITS) definition⁶ in determining securities and liabilities is not fit for purpose and creates distortions. Furthermore, they stated that assets like subsea cable links are more closely align with shared use transmission infrastructure.

SSEN as well as other connections customers have also reiterated that Orkney connections customers are at a competitive disadvantage because of the securities faced by developers.

In addition, SSEN has urged us to consider the *actual* risk that is being put on consumers, in the event of Part 2 being approved. SSEN are arguing that the risk involved with the derogation would be low and an element of risk is already placed on the consumer in the current methodology.

Our view

Alternative Approach: Part 2	
<i>Consideration</i>	<i>Our view</i>
Consumers	<p>Although we do think that Part 1 of the AA will go some way to mitigate the risk of SHE-Transmission incurring inefficient expenditure, we consider the shortfall of securities in a worst case scenario (one or a number of, developers terminating their connection agreements and no-one being able to take their place in the queue) to be significant.</p> <p>We do not think it is appropriate to use either the pre-construction expenditure or Allowed Expenditure mechanisms to absorb this risk, as this would be ultimately passed to consumers.</p>
Competition	<p>Although we recognise the high costs of securities incurred by developers on Orkney compared to the mainland, we believe this to be reflective of the costs of carrying out the necessary expansion. These cost are consistent with the costs faced by other developers wishing to connect on</p>

⁵

https://www.ofgem.gov.uk/system/files/docs/2018/12/ofgem_consultation_on_ssen_derogation_request_for_orkney_alternative_approach.pdf

⁶ Connecting Orkney generators are liable for 100% of their share of the costs of new assets needed to connect them up to the MITS ("attributable works"). The liability for reinforcement costs from the MITS ("wider works") is shared more broadly between all generators in the zone and with consumers on a 50/50 basis.

	<p>other remote islands and areas requiring significant extension of the network.</p> <p>We maintain that this part of the proposal would give customers that are part of the trial an unfair advantage over other developers in Orkney and GB more generally. To be clear, we think this element is significantly different to allowing customers to unfix as part of Part 1 – as in Part 1, there aren't any significant reduction in liabilities and securities.</p>
Sustainable development	<p>It is possible that by temporarily adjusting liabilities, some more renewable projects might be connected in Orkney, thus potentially contributing to sustainable development. However, we do not think this justifies the increased cost risk to consumers and think that it could risks costs to consumers of decarbonising electricity supplies being higher than necessary.</p>
Health and safety and the associated risk management measures	<p>We do not consider the proposal in Part 2 to have any significant impact on Health and Safety and the associated risk management measures.</p>
Other parties affected by the non-compliance, including the ability of the relevant system operator or DNO to operate its system	<p>SSEN is proposing to adjust attributable liabilities by SHE-Transmission by not passing through elements of the attributable costs estimates associated with the subsea element to the ESO. This means the ESO will also be using a lower attributable works value in the calculation of developers' liabilities (whether they have opted for fixed or variable liabilities). This will therefore reduce the securities paid by developers.</p> <p>The requirements for calculating attributable work costs and attributable works capital costs are set out in multiple sections of the CUSC. In line with the definition set out in the CUSC, SSEN do not think this approach to require a derogation as the Standard Terms of Connection (STC) under section 12.1 of Schedule 9 allows SHE-Transmission to provide the ESO with the attributable works information in a form agreed by SHE-Transmission and the ESO. SHE-Transmission is proposing to have an agreement with the ESO, as well as a separate agreement with SHEPD.</p> <p>To implement the adjusted liabilities proposal of the AA, there is an implicit expectation that the costs passed through from SHE-Transmission for the attributable works costs are the actual costs incurred.</p> <p>We still think that this is a significant deviation from the intent of the STC and it also requires the ESO to be complicit in this arrangement.</p>

With regard to SSEN's comments on the use of MITS - User commitment arrangements have been developed over time to ensure that the liabilities placed on network users are reflective of the risk that any change in their plans would pose to efficient transmission investment, ultimately protecting consumers.

As we explained in our minded-to view, when a developer applies to connect to the transmission system or to increase its existing capacity, Transmission Operators (TOs) undertake the required reinforcement works to the electricity network to accommodate its needs. If a developer cancels their project or reduces the level of capacity they need, yet

associated works have already begun at a cost to the relevant TO, then if those costs were not recoverable from the developer it would result in higher costs for consumers.

CMP192 (a modification to the industry code that contains the user commitment rules) sought to reduce the barriers faced specifically by smaller parties and recognised the role securities and liabilities can play in the viability of a project. However, our Decision⁷ in CMP192 was in principle rooted within Ofgem's primary objective of protecting customers. The decision recognised that any approach to user commitment arrangements should reduce the risk of inefficient network investment and should protect consumers from this risk where possible. The decision specifically states that these arrangements should reflect the risk of cancellation/reduction in capacity by projects to consumers. So whilst we recognise the high costs of securities incurred by Orkney developers, we believe this to be reflective of the costs of carrying out the necessary work.

We have not seen convincing arguments that there are problems with the current arrangements for ascertaining which assets will form part of the MITS as a basis for determining users' level of securities and liabilities. The intention is to distinguish between where new investments will bring a benefit to a broad group of users (wider assets), and those that are for the purpose of connecting specific users (attributable assets). We consider that the new transmission link to Orkney is being developed for a specific group of generators.

We do not see a good case for allowing these generators to face less stringent user commitment requirements than developers looking to develop generation in other areas of Great Britain (including in other areas which are remote from the MITS). This would give Orkney developers a relative advantage and would distort competition. While it could support additional generation projects being developed on Orkney, taking into account the potential for unnecessary transmission reinforcement costs to be passed through to consumers it could lead to worse consumer outcomes than if all generators (including low carbon generators in other parts of the country) were competing on an equivalent basis.

SSEN also highlighted that the current methodology and arrangements can already put some risk onto consumers. Whilst we do think the queue management process in Part 1 may mitigate some risk to consumers in the event of the worst-case scenario if Part 2 is implemented; we do not think that any *additional* risk should sit with consumers as a result of this derogation.

Various industry-led projects have been looking at user commitments and whether or not the current arrangements are fit for purpose. We maintain that any proposed changes to general user commitment arrangements, for example to put forward improvements to the wider/enabling works boundary, should be dealt with through the code modification process and not a one-off derogation.

We also maintain that SSENs proposed use of pre-construction expenditure or the Allowed Expenditure mechanism to absorb risk is inappropriate.

⁷ <https://www.ofgem.gov.uk/sites/default/files/docs/2012/03/cmp-192-d.pdf>

Our decision

Following our consultation, our decision is to reject Part 2 of the AA.

Our decision is anchored in our obligation to protect consumers and we maintain that these proposals place an undue risk on consumers, whilst giving Orkney developers an unfair competitive advantage over other generator developers.

Yours sincerely

Jon Parker
Head of Electricity Network Access