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Consultation on Scottish Hydro Electric Power Distribution's proposals to contribute towards proposed electricity transmission links to Shetland, Western Isles and Orkney

Dear James,

National Grid Electricity System Operator (NGESO) welcomes the opportunity to respond to your consultation on the Scottish Hydro Electric Power Distribution (SHEPD) proposals to contribute towards proposed electricity transmission links to Shetland, Western Isles and Orkney. NGESO became a legally separate entity on 1 April 2019. As the ESO we use our unique perspective and independent position to facilitate market based solutions which deliver value for consumers. We are responding to this consultation as NGESO given its relevance to the industry codes and licences and this response is not confidential.

In our response, we have focused on providing views on the mechanics and practicalities of implementing a contribution from a Distribution Network Operator (DNO) to a Transmission Owner (TO) into the existing regulatory frameworks, agreements and methodologies. We believe that:

- The transfer of money between DNO and TO needs to be recognised in licences and a new mechanism needs to be created to allow for a 'capital contribution' in this context. At present a DNO making a capital contribution toward the cost of transmission infrastructure is not recognised in the regulatory framework.
- In the case that the transfer of money impacts on Transmission Network Use of System (TNUoS) charges, this should be clearly included in the Connection and Use of System Code (CUSC). At present the concept of a 'capital contribution' made by a customer (who pays TNUoS charges) does partially exist for TNUoS charges in limited circumstances (following CMP203), however the concept of capital contributions made by a DNO towards infrastructure assets is not included in the CUSC. By clarifying this arrangement in the CUSC, it will enable the new mechanism to be transparent and subject to open governance for other industry parties.
- As a minimum, we feel that changes to CUSC Section 14 are needed to reflect that part of the annuitized cost of the island link circuits is being recovered elsewhere, and consequently how the TNUoS charges are affected. There is a need to ensure the costs are recovered adequately, but also that the efficient economic signals are maintained in respect of TNUoS charges.

More information on these points can be seen in our more detailed response to Question 3 appended to this letter below.

We welcome the opportunity to further discuss the points raised within this response. Should you require any further information or would like clarity on any of the points outlined then please contact Mike Oxenham in the first instance at Michael.Oxenham1@nationalgrideso.com.

Yours sincerely,

[By Email]

John Twomey
Markets Development Manager, Future Markets

Responses to your questions

Question 3: What are your views on how the methodology could be most appropriately implemented? Do you agree that more detail is required on the proposed implementation of the contribution in SHEPD's licence and industry codes before we can approve any proposal? Would it be more appropriate for the SHEPD proposals to be formally considered through standard industry code governance arrangements?

At this stage, we agree that there is less clarity or certainty on how the SHEPD proposal would be implemented through industry codes and licences than required to do so. A DNO making a capital contribution toward the cost of transmission infrastructure is not currently recognised in any of the DNO, TO or ESO licences, nor in the CUSC; the exception being in relation to very specific pieces of equipment e.g. under connection charges the concept of a capital contribution exists.

Island links will not fall under the CUSC definition of a connection asset as connection assets are defined in CUSC as single user assets and in the case of cables or overhead lines must be no longer than 2km in length and crucially they are not potentially shareable.

At present, once island links are constructed they would form part of the Regulated Asset Base (RAB) and be included in the allowed revenue for the TO. NGESO is responsible for the recovery, through TNUoS charges, of this allowed revenue and has an obligation to keep the charging methodologies under review and this is subject to open governance.

Allowing another party to make a capital contribution towards a transmission circuit, such as an island link, needs to be recognised under the price control, regulatory frameworks and industry documents. A new mechanism for the transfer of money between a DNO and TO should therefore be created to allow the capital contribution to be most appropriately implemented in licence(s) and code(s).

The SHEPD proposal requires a mechanism to enable a portion of the TO allowed revenue to be paid directly to the TO from the DNO. Another possible mechanism would be to allow a proportion of the TO allowed revenue to be recovered from the DNO through TNUoS charges. In this case, this should be included in the CUSC and the TNUoS methodology. TNUoS charges are calculated and levied to parties in accordance with the methodology in CUSC Section 14. The cost recovery associated with island links is partly through a bespoke local circuit tariff (£/kW) and partly socialised. The concept of 'capital contribution' does not currently exist for TNUoS charges in this context.

In any case the ESO would need full sight of the values in question, in accordance with TNUoS tariff setting timescales, to allow tariffs to be effectively set, managed and recovered. CUSC Section 14 will need clarification on the treatment of any remaining allowed revenue for the island link to ensure the costs are recovered adequately (e.g. avoiding any "double recovery") and so that efficient economic signals are maintained.

Importantly, we should ensure implementation of this proposed capital contribution in CUSC is robust and transparent. The existing modification CMP303 ('Improving local circuit charge cost-reflectivity') will not sufficiently address the issue. A separate code modification will be required to change the charging methodology to recognise that a proportion of the cost of the link is being paid through another means.

Therefore, we believe a targeted and specific modification on this issue is required due to the heavy scrutiny over this section of the CUSC (i.e. Paragraphs 14.15.75 and 14.15.76) through both CMP301 and CMP303. Indeed, industry encouraged us to clearly define the project costs that would be included in the local circuit tariff calculation for HVDC and sub-sea AC links for island projects through a formal modification proposal (CMP301) whilst we would have been content clarifying our interpretation through industry forums. There are large sums involved in the development of these island links for transmission export and significant impacts on TNUoS liabilities for customers in the locality. Therefore, we believe that a clear instruction of tariff calculation which accounts for the option that a DNO makes a capital contribution to a given link is required to remove ambiguity for CUSC parties both present and future. We are aware that this transaction will take place outside the CUSC and outside of open governance frameworks for transmission charging. In summary, due to the sensitive nature of this section of the charging framework we agree a CUSC change proposal should be developed to clarify the treatment of remaining project costs in the TNUoS methodology after the removal of any Ofgem approved third party capital contribution.

In addition to the suggested CUSC change it is necessary to raise an STC change to ensure the data transfers between NGESO and the TOs is complete and correct for charging purposes and there is no ambiguity on how to process the data through the TNUoS methodology for the ESO charging teams. Again, we believe this is the case given the large sums involved and the need for transparency through all these processes which is available to all parties.

In saying this it could be possible for a policy direction to be set in this regard prior to code modifications being raised to explore the most effective way to implement the policy direction i.e. if Ofgem take a decision on the principles prior to a code modification being raised this process could then subsequently present options for a means of implementation whilst noting the applicable objectives of the relevant code(s).