

James Norman

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10 July 2019

Dear Mr Norman

### **Consultation of SHEPD's Proposal to Contribute to Proposed Transmission Links to Western Isles, Orkney and Shetland**

Thank you for providing us with the opportunity to respond to the above consultation.

The Scottish Highlands and the Islands off the north and west coast represent a large geographical region. The region has a low population density with many pockets of population spread across areas that are often remote. The region is home to a large volume of renewable energy power stations – from small scale, local developments to very large commercial installations. There are many more sites across the region that could be exploited to provide yet more cost effective, low carbon, renewable energy. The region is served by a single distribution network owner – Scottish Hydro Electric Power Distribution and a single transmission owner – Scottish Hydro Electricity Transmission.

Highlands and Islands Enterprise (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, The Highland Council and Argyll & Bute Council, have jointly made representations over many years on behalf of industry to influence the way in which regulation of the energy industry is managed to ensure the needs and interests of the Highlands and Islands are understood and taken into consideration.

Much of our effort has been focused on influencing and supporting the case for investment in new transmission infrastructure to the Western Isles, Orkney and Shetland. These investments are critical to enable the significant renewable energy resources in these areas to be exploited and thereby contribute to the UK's response to the climate emergency and move towards achieving a net zero energy system.

We have previously responded to Ofgem consultations on the needs cases for the islands, supporting the proposals as submitted by SSEN. We hope that Ofgem will announce its decision in relation to each of these quickly. We are now pleased to also be given the opportunity to comment on SHEPD's proposals to contribute to these transmission links. We are entirely supportive of any moves which can further strengthen the case for each of these investments, whilst ensuring that consumers remain protected. We are aware that Comhairle nan Eilean Siar will be responding separately to this consultation, and while we entirely support the approach for Shetland, we share the Comhairle's concerns

that an equally robust methodology is required to ensure that the other islands similarly benefit from this proposal.

We look forward to seeing the results of the consultation in due course.

Yours sincerely

A handwritten signature in black ink that reads "Elaine Hanton". The signature is written in a cursive style and is positioned above the printed name and title.

Elaine Hanton  
Head of Energy: Emerging Technologies and Regulation

In partnership with:-  
Shetland Islands Council  
Orkney Islands Council  
The Highland Council  
Argyll & Bute Council

**1. What are your views on the principle of DNO contributions to transmission projects generally, and contributions by SHEPD to the Shetland, Orkney and Western Isles transmission projects specifically?**

Given the rapidly changing energy landscape we support a ‘whole system’ approach and recognise that regulation, and indeed energy networks, need to be able to respond to these changes. We believe this change should include the principle of DNO contributions to transmission projects where network investment is needed, such as in the case of Shetland, Western Isles and Orkney. Collaboration between distribution and transmission network operators could support greater energy diversification, including enabling access to renewable energy sources in more remote locations.

Scottish Hydro Electric Power Distribution plc (SHEPD)’s contribution proposal for the Shetland transmission link is essentially spearheading the whole system concept in the North of Scotland, where investment by SHEPD into Scottish Hydro Electric Transmission plc (SHET) assets will enable cost efficiencies and operating benefits. Collaboration between SHEPD and SHET presents a more holistic approach to tackling technical issues and we believe this will ultimately deliver the most economical and efficient solution for energy consumers.

For Shetland, the interconnector, whether it be transmission or distribution, needs to be in place to facilitate renewable generation export, provide energy security and to deliver significant reductions in the current high-carbon intensity of the islands’ electricity supply. There is an imminent energy supply challenge on Shetland with Lerwick Power Station which is responsible for most of Shetland’s supply now reaching the end of its operational life. Following Ofgem’s decision to reject the Shetland New Energy Solution in 2017 [1], there is an urgent need to address future options to ensure energy security on Shetland while ensuring these options are economically viable. We believe that SHEPD’s financial contribution will enable the best possible opportunity to facilitate the creation of more sustainable forms of energy generation as well as ensuring the future supply of demand on Shetland.

We are also supportive of the SHEPD proposal being developed further to equally enable the renewable potential of Orkney and the Western Isles to be fully exploited. This is aligned with the Scottish Government’s commitment, now set in statute through the Islands Act 2018, to deliver local and community energy projects and develop island economies. Scottish Government’s vision for Electricity Networks by 2030 is to achieve substantial investment in new capacity for Scotland’s electricity networks, including transmission links to island groups [2].

**2. What are your views on the robustness of the methodology to determine the need for and value of the contribution? Do you agree with our views on the methodology proposed for Shetland and Western Isles/Orkney, as set out in Annex 2?**

We believe that SHEPD's fair value contribution methodology is robust and agree that the full cost of a future distribution link should be the value of the contribution. This is because, without a transmission link, SHEPD will have to secure another solution and SSEN's evaluations show that an alternative distribution link will cost £140m more than the financial contribution [3].

The only element of the methodology that Ofgem appears to be uncomfortable with is 'capacity support'. The consultation outlines that SHEPD consumers are most at risk of making an over-contribution towards the link where the generation on Shetland exceeds SHEPD's assumed production curves and capacity factors, and therefore, the network charges would shrink for distribution customers. While we agree that it is possible that Shetland could have higher levels of energy export than modelled, SHEPD indicate that the impact would be small. These curves are reliable as it is the same production curves and capacity factors used in the SHET Needs Case meaning that the methodology is consistent and up-to-date.

Ofgem's concern surrounding an underutilised link, a scenario where less than 600MW of generation comes forward, is highly unlikely given that Viking Energy (457 MW) and Beaw Field (72 MW) are consented, Energy Isles (120 MW) has applied for consent, and Mossy Hill (50 MW) has an open offer from National Grid Electricity System Operator plc (NGESO) and SHET to use the 600MW link with curtailment when the link is overloaded.

SHEPD's contribution methodology is also aligned with Ofgem's commitment to protect the consumer, as a cap will be in place on the financial contribution, even if inaccuracies occur in the methodology.

In short, we believe that the contribution methodology is credible and we encourage Ofgem to accept the proposals given that an alternative solution will cost substantially more.

The issues for Orkney and the Western Isles are different as they are already connected to the mainland grid and do not have the same level of urgency as Shetland in relation to security of supply. We are entirely supportive of SHEPD applying the same robust process as it has for Shetland to these other islands to quantify fairly the contribution value of the transmission links, and determine how the same principles could be applied to ensure these island equally benefit.

**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?**

SHEPD developed a comparison method across the solutions and identified option 3 as the best value solution. Given the optioneering process in which SHEPD engaged with external consultants, we believe that its preference for option 3 (SHEPD payment under contract with relevant Transmission Owner (TO)) is justified. Option 3 is simpler in that it requires less change to current industry mechanisms and therefore avoids legal/regulatory burdens. We agree with SHEPD that industry code arrangements should not delay Ofgem's decision making process, particularly when there are tight timescales attached to the proposal. We do however encourage SHEPD to engage with the industry code process to mitigate against potential legislative risks.

We also agree that the transfer of funds from SHEPD to SHET should be made as a one-off payment only on energisation of the transmission link, as this will ensure security to SHEPD customers. Ultimately, we want to encourage Ofgem to find a mechanism which can quickly and easily be implemented to enable payments to be made, and the project to progress efficiently.

**4. What are your views on timing for confirming the contribution? Are there other areas of uncertainty within the proposals or wider frameworks that we have not considered, and which would impact the effectiveness of the SHEPD proposals?**

Although the contribution will not impact the island Needs Cases, we hope that Ofgem will provide a quick response to SHEPD's proposal. If the recommendation is not accepted, there are a number of alternatives that SHEPD will have to consider which will take time.

**5. What are your views on any wider implications that should be considered? How can any wider implications best be managed?**

The locational charging element of Transmission Network Use of System charges (TNUoS) and the way in which it is levied on radial links to Scottish Islands has already been identified as a defect through Project TransmiT [4], CMP301 and CMP303 [5]. However, there are wider implications that need to be considered with regards to TNUoS that are not yet the subject of a CUSC modification. This includes the estimates of the wider zonal tariffs in NGENSO's five-year forecast if the islands are treated as distinct TNUoS zones.

Further, we are aware of the interaction between SHEPD's contribution and CMP303, which aims to reduce the local circuit charges for island generators by removing any additional costs not directly associated with those generators. The current Change Proposal will help in 'levelling the playing field' for island generators as it proposes ways to change the calculation methodology, including an option similar to the fair value contribution approach (WACM 4). Therefore, we encourage Ofgem to continue to assess both work streams in parallel, especially if CMP303 could offer a route for the implementation of SHEPD's proposals.

