

Olivia Powis  
Ofgem  
Commonwealth House  
32 Albion Street  
Glasgow  
G1 1LH

08 February 2019

Dear Olivia,

**Derogation request for Scottish Hydro Electric Power Distribution PLC (SHEPD) to implement a proposed trial of their Alternative Approach on Orkney**

As set out in our public consultation documents and derogation request, SSEN has proposed an Alternative Approach (AA) which seeks to address current barriers to connection faced by customers on Orkney. The AA comprises a technical and commercial policy solution. The technical solution is a staged approach to reinforcement (as set out in SHE Transmission's Needs Case, submitted on 6 March 2018) and the commercial solution includes proposals to trial a "Ready to connect process (Part 1)" and "Temporary adjustments to securities and liabilities (Part 2)". Proposals have been developed in direct response to concerns raised by customers on Orkney over several years and are the result of extensive stakeholder engagement and consultation.

**The Ready to Connect process (Part 1)**

The AA sets out alternative arrangements to be trialled for allocating capacity and managing the connection queue. Arrangements would ensure capacity is allocated to customers who can demonstrate readiness to connect through 6 monthly submission of delivery plans and the ongoing review of plans against predetermined milestones. In comparison to current arrangements whereby the first to contract has the first choice of connection date, the AA will ensure capacity is allocated more efficiently and utilised fully, from the earliest date. We agree with Ofgem that this will reduce the risk of inefficient investment and stranded assets. SSEN alongside the ENA believe the trial will also provide crucial learning for wider GB developments in this area. As such we welcome Ofgem's proposal to approve the derogation request for the Ready to Connect process.

**Temporary adjustment to securities and liabilities (Part 2)**

Island customers have repeatedly raised concerns regarding the significant barrier to entry created by current security and liability arrangements. While CMP 192 sought to remove some of these barriers, the use of the MITS node in determining securities and liabilities created distortions as it included the significant cost of subsea cable links in security and liability calculations. These assets more closely align with shared use transmission infrastructure which

would normally be included in security and liability calculations for wider works on the GB mainland, rather than attributable works<sup>1</sup>.

Given the cost associated with subsea cable links, this places island projects at a material competitive disadvantage relative to similar projects on the mainland; to demonstrate this point, securities for Orkney projects are on average 4.5 times higher than similar projects on the North of Scotland mainland.

The AA sought to address this issue and create a level playing field by trialling alternative arrangements for a 9-month period which remove subsea cable costs from calculations. The trial would help establish whether this is sufficient to remove current barriers, create a level playing field and unlock Orkney's renewable potential. Learning would also help inform wider industry developments in this area e.g. modifications to arrangements set out under CMP192 under Ofgem's SCR.

#### **Ofgem's concerns**

Ofgem has raised concerns that alternative security and liability arrangements would provide an unfair competitive advantage for developers on Orkney. To describe the proposed derogation as conveying an unfair advantage is misrepresents current arrangements. As set out above, Orkney customers have repeatedly raised concerns with us, and Ofgem, that they face a material competitive disadvantage relative to customers on the GB mainland. This was demonstrated in our submission comparing the scale of securities for island and mainland projects and as referenced above. Our proposals sought to address this disparity and ensure customers operate and compete on a level playing field.

Ofgem has also raised concerns that proposals transfer risk from developers to consumers and that this risk could be significant should developers reduce capacity or cancel projects. We strongly disagree with this assumption. The risk that a material number of projects would reduce capacity or cancel within the proposed 9-month window of the trial is extremely low, particularly as several customers (including smaller developments and community schemes) have recently indicated they are already investing a significant amount of time and financial resource, working to secure planning consent ahead of the relevant trigger. Under standard industry security and liability arrangements, this will automatically reduce a developer's financial burden.

As discussed previously, we believe only the incremental risk should be considered in Ofgem's assessment. SSEN has provided Ofgem with information to demonstrate the value of this incremental risk and that the probability of it materialising is low. Evidence from stakeholder engagement also demonstrates that at the reduced level, security and liability arrangements

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<sup>1</sup> Wider works liabilities are share 50/50 between the consumer and connection customers; whereas attributable works requires 100% liabilities from the connection customer

will continue to provide a strong commitment from customers. Coupled with the significant investment developers have already committed e.g. on environmental and bird studies, planning application preparation and site studies, we believe Ofgem should have convincing evidence to conclude that asset stranding is not a material risk or burden for GB consumers.

#### **Ofgem's alternative conditionality proposal**

As an alternative to customers signing up to the AA to demonstrate commitment, Ofgem has proposed through the Needs Case consultation that its final approval of the investment would be conditional upon SHE-Transmission being able to demonstrate by December 2019 that not less than 135MW of new generation has made a commitment to connect. Ofgem has proposed that this would be evidenced through:

- The award of a Contract for Difference in the 2019 CfD Auction; or
- The project having secured planning consent and finance to support construction.

SSEN strongly disagrees with this approach. Ofgem's proposals, rather than seeking to address concerns and imbalances, exacerbate them; introducing further distortions and barriers to entry. Conditionality tests should not require developers to advance project development (planning and financing arrangements) beyond what is reasonable more than three years ahead of energisation.

We recognise customer commitment is important and as a result developed the AA milestones to help demonstrate this. However, we do not believe developers on Orkney should face a tougher set of financial tests relative to developers elsewhere in GB. Ofgem's proposals would place conditions on developers on Orkney that would not be required if they were looking to connect on the GB mainland. Ofgem has not provided any clear justification for such an approach.

Applying tests beyond common industry standards is also at odds with SSEN's wider objectives under the Electricity Act and licence which require licensees to develop, operate and maintain networks in an economic and efficient manner and to facilitate competition in generation.

**SHEPD has demonstrated securities faced by developers on Orkney under standard arrangements, are 4.5 times higher than on the North of Scotland mainland. If Ofgem is minded not to support Part 2 of the AA the conclusion must be that, because of these increased sums, industry standard securities provide a very strong indication of a developer's commitment to progress.**

#### **Implementation timescales**

SSEN's derogation request recognised the potential need to amend implementation dates following consultation. Following the recent announcement by SHE-Transmission of a delay in

energisation date from October 2022 to April 2023, we would look to engage with Ofgem separately on timescales.

### **Conclusion**

The barriers to entry faced by customers looking to connect on Orkney are significant and have existed for some time. They are also well documented. SSEN has worked with all relevant parties, including Ofgem, over several years to try and find a pragmatic and proportionate solution to address these concerns. The proposals set out in our AA have been developed in direct response to concerns raised and have been guided by stakeholder input. We believe the current barriers place customers on Orkney at a distinct competitive disadvantage. SSEN believes the AA strikes a reasonable balance and offers a pragmatic solution to restore the balance.

SSEN welcomes Ofgem's minded to decision to approve the Orkney needs case to address the long-standing need for reinforcement. We believe that on balance, part 1 and 2 of the AA meet the relevant objectives and provide a strong commitment from customers to proceed with connection while addressing the current imbalance and competitive disadvantage faced. We also believe the materiality and probability of any incremental risk arising and being transferred to GB consumers is extremely low. As such we urge Ofgem to implement part 1 and 2 to address the current competitive disadvantage faced by Orkney customers. If, however Ofgem decides to reject part 2 of the AA, we strongly believe Part 1 of the AA combined with industry standard arrangements for securities and liabilities is sufficient to address any concerns regarding user commitment. We do not agree that customers on Orkney should face a significantly higher test and burden relative to those on the GB mainland. This would only serve to exacerbate the current imbalance.

If Ofgem decides to reject Part 2 of the AA we also ask Ofgem to facilitate development of alternatives to address the long-standing industry concerns regarding security and liability arrangements given a collaborative and constructive approach is required across all relevant parties to finally move this forward.

Our response to the specific questions raised by Ofgem is set out below. We have also provided supporting information in the two appendices attached. If you would like to discuss any aspect in more detail we would be happy to assist.

Yours sincerely

Beverley Grubb  
Head of Network Regulation (Distribution)

## Section 1: Derogation Request – Part 1: The Ready to Connect Process

Question 1: Do you agree that SSEN's ready to connect trial will provide valuable learning in line with the Energy Networks Association's (ENA's) proposals on interactivity and queue management?

SSEN strongly agrees that the Ready to Connect trial will provide valuable learning in relation to the ENA's Workstream 2, product 5 on interactivity and queue management. We believe it will build upon learning derived from previous industry work through the ENA, Scottish Power Energy Networks and National Grid ESO. The following key learnings will be invaluable to the industry in applying queue management on a GB basis:

- **Access Rights:** The Ready to Connect Process will allow us to test an alternative mechanism for the initial allocation of capacity in the connection queue, allocating available capacity to those who are ready to connect rather than based upon when they originally signed their connection offer; this will allow us to assess the extent to which this helps maximise the use of available capacity relative to the status quo.
- **Applying industry change to existing contracted parties:** The ability to apply significant policy changes to existing contracted parties is often a blocker to meaningful change. The approach set out in the trial will allow valuable lessons to be learned regarding if and how successfully, policy changes can be applied on a voluntary basis in existing commercial contracts.
- **Interactivity:** The Ready to Connect process will act as a pre-cursor to the interactivity process by allocating capacity to the customer who has demonstrated they would be ready to connect earlier, which could avoid an unnecessary interactivity process. Overall, this could lead to improved efficiencies in the connection process.
- **Queue Management:** The Ready to Connect process would be an industry first; demonstrating how managing a queue based on how ready a customer is to connect would work, as well as how this will relate to physical works, commercial arrangements, securities and liabilities. As Orkney is a radial extension, this will allow arrangements to be trialled in a more controlled manner, on a simpler part of the Main Integrated Transmission System where there are similar or shared reinforcements required for all customers. This is different to the mainland, where reinforcements required by connection customers can vary significantly.
- **Whole Electricity System Approach:** In previous industry work streams focussing on queue management, there was concern regarding the practical difficulties associated with implementing such arrangements across GB with many parties involved (connection customers, DNO, ESO and TO). These practical difficulties resulted in queue management proposals being delayed and moved into the ENA Open Networks.

The trial will allow valuable lessons to be learned from a real-life example applied across the full range of parties on Orkney in a controlled environment. This will inform future decisions regarding how this can be applied on a whole system basis before being progressed across the GB system.

Key learnings from the Ready to Connect process are outlined in our previous response (attached as Appendix 1).

**Question 2: Do you agree that the proposals (subject to all affected connection customers agreeing to sign up) allocate the available capacity in a fair and transparent way?**

SSEN strongly agrees that the proposals allocate capacity in a fair and transparent manner for two main reasons:

1. **Collaboration with stakeholders:** Proposals have been developed from the previous industry standard milestones and in line with stakeholders' feedback over the last year through consultation and bilateral meetings. Crucially, to ensure fairness and transparency, milestones are defined in advance and will be applied consistently to all customers. They also include a tolerance to ensure any delays to a customer's project out-with their control, are treated in a fair and consistent manner. All feedback from stakeholders to consultations has been published on our website to ensure there is transparency surrounding the changes made. An example of this is that changes were made to the progression milestones and the associated standard timescale following stakeholder feedback to our public consultation and stakeholder events.
2. **Transparency of capacity allocation process:** To ensure the process is consistent and transparent, commercial contracts will be varied across all relevant parties within the trial. This will be accompanied by guidance documents for the ready to connect process. For example, SSEN has initiated the Ready to Connect process by writing to relevant customers requesting their delivery plans. Included within this correspondence is a guidance document setting out the pre-defined milestones and standard timescales, as established following consultation (see Appendix 2). A further guidance document will accompany customers' varied connection contracts and will outline the queue management rules. Upon implementing the trial, both documents will be published on our website to ensure full transparency of the process for all industry participants. In addition to the contractual changes and guidance documents, each customer's dedicated contract manager will walk them through the changes to ensure these are fully understood by all.



Question 3: Do you agree with our minded-to position that if this trial is implemented in a clear, fair and transparent way, there is no significant impact on consumers, competition, sustainable development, health and safety or other parties?

We strongly agree with Ofgem's minded-to position that there would be no significant negative impact on consumers, competition, sustainable development, health and safety or other parties from the implementation of the Ready to Connect trial. We believe consideration should be given to the significant positive impact the trial would provide:

- **Consumers:** We agree with Ofgem's view (as outlined in its consultation), that the Ready to Connect process will mitigate the risks associated with stranded assets, thereby reducing the risk and associated costs to consumers. The Ready to Connect process also ensures that capacity is allocated in the most efficient manner by allowing those who are ready to connect to move up the queue. This will ensure that any reinforcement is fully utilised as early as possible and delivers value for money for the GB consumer.
- **Competition:** The Ready to Connect process will further incentivise customers to plan and manage their projects to connect on time. If Ofgem approves SHE-Transmission's Needs Case, there will also be increased competition in generation. This will, as demonstrated in our Needs Case, support Orkney's ambition to unlock its renewable potential and help deliver a reduction in GB wholesale electricity prices, providing significant consumer benefit (please see our response to Question 5 of the Needs Case consultation).
- **Sustainable development:** The Ready to Connect process will enable Orkney customers to connect to the network through the most efficient and economical way of allocating capacity. Overall this is in line with both SSEN's sustainability objectives and wider obligations under the Electricity Act.
- **Health and safety:** Safety is SSEN's top priority. We empower all SSEN staff with a licence to stop work if they do not consider it to be safe: *'if it's not safe, we don't do it'*. This also applies to the implementation of the Ready to Connect process. There is no detrimental impact on how connection schemes will be operationally and physically delivered under the process; if a developer requests an earlier connection date SSEN will evaluate whether this can be delivered following the same health and safety standards as those associated with any connection, ensuring there is no additional pressure on delivery. The Ready to Connect process also incentivises customers to establish a realistic programme at the start of the connection process thus avoiding any unnecessary pressure on delivery. In addition, we have also developed a tolerance allowance to provide flexibility for the customer when they face potential delays which are out-with their control.

- **Trial Approach:** Trialling the Ready to Connect process will allow us to test arrangements in a controlled environment, measure the benefits that GB wide implementation could deliver as well as safeguard against any unintended consequences.

## Section 2: Derogation Request – Part 2: Temporarily adjusting liabilities

Question 4: Do you agree that the proposal to temporarily adjust liabilities will pass unnecessary risk to consumers?

We do not agree that the temporarily adjusted liabilities pass on an '*unnecessary*' risk to consumers for the following reasons:

- **The purpose of changes to the securities and liabilities process brought in under CMP 192 was to enable competition in generation and reduce the obstacle to connection faced specifically by Distributed Generation customers.** As recognised at the time of implementation, this has not had the intended effect for Orkney customers and the obstacle has not been sufficiently reduced. The securities and liabilities for Orkney customers are around 4.5 times higher than those for North of Scotland mainland customers, so there continues to be a significant upfront barrier to connection which smaller DG projects in particular cannot overcome. Rather than introducing an 'unnecessary risk' to consumer, the proposed temporary adjustment to liabilities ensures Orkney customers can operate on a level playing field relative to mainland connection customers. Overall alternative arrangements will also help increase competition in generation which could benefit the consumer through a reduction in wholesale prices.

Following further engagement in response to Ofgem's consultation, stakeholders have told us there is still a need for alternative security arrangements to address the current imbalance relative to mainland projects and to remove the relative disadvantage they face. Some, smaller projects, have also indicated they will now most likely seek planning consent prior to progressing projects due to the scale of the financial burden of securities and liabilities. Planning permission is intended to act as an incentive for projects to progress by reducing the amount of security required to 10% (26% for DG customers) rather than being the only viable option for a project to progress a connection. The move to have planning permission prior to progressing a project demonstrates the significant barrier to connection still faced by Orkney customers.



- **Recent stakeholder feedback confirms the temporary reduction of securities and liabilities under the AA proposal still retains a strong incentive for customers to provide timely notice of cancellation<sup>2</sup>**, as the securities and liabilities faced remain significant. Combined with wider time and financial commitments e.g. carrying out studies and progressing planning, this mitigates the risk to GB consumers. If securities and liabilities are placed during the relevant window of reduced securities and liabilities under the trial, this is still a strong signal from projects that they are likely to proceed to connection whilst at the same time removing the initial barrier to connection.
- **The current securities and liabilities methodology already places an element of risk on the consumer**, through sharing the risk between the consumer and generator for wider works and National Grid ESO's ability to recover costs from consumers should a generator fail to pay the cancellation charge upon cancelling their project for both attributable and wider works. As a result, the consideration should be whether the AA introduces a material and disproportionate incremental risk. As previously demonstrated, we do not believe this is the case. The incremental risk associated with the AA is small. As presented in our meeting with Ofgem on 13 September 2018, SSEN views the probability of the risk materialising to be low; this is mainly due to customers still being required to place securities, on a more comparable basis to mainland customers, which would incentivise them to connect.
- **The trial approach for Orkney would also provide valuable learning to then input into Ofgem's Significant Code Review**, focusing on access and future charges or feed into a code change under the CUSC to minimise any unintended consequences in changes to securities and liabilities. Securities and liabilities remain an issue across the industry which is reflected in both Ofgem's consultation and National Grid's (ESO) open letter. This is particularly relevant for customers in the North of Scotland who are more likely to have an impact on the Transmission System, due to the growth in renewables causing network constraints.

Question 5: Do you agree that the proposal provides an unfair competitive advantage to those customers who would benefit from a period of adjusted liabilities?

SSEN strongly disagrees that the proposal provides an unfair competitive advantage to Orkney customers. The proposal only focuses on reducing the initial barrier to connection for a limited period to bring Orkney customers in line with mainland customers, through the security and liabilities provisions under the trial. Rather than introducing an 'unfair competitive advantage',

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<sup>2</sup> CMP 192 Guidance document, page 3, Version 0.1 dated 29 January 2013 which describes the purpose of securities as an incentive for customer to provide timely notice of cancellation

the proposed adjustment ensures Orkney customers can operate on a level playing field with mainland connection to redresses the current imbalance. Proposals have been made in direct response to concerns that current arrangements create an unfair competitive “disadvantage” for Orkney customers.

Also, arrangements are for a limited time only to test they appropriately address the current imbalance and to enable learnings to be gathered. This includes identifying any unintended consequences. This further mitigates the risk of introducing an unfair competitive advantage.

**Question 6: Do you agree with the proposed mechanism of offering adjusted liabilities (i.e. by SHE-Transmission not passing on the unique subsea costs to the ESO, who in turn does not pass them to end connection customers)?**

Yes, we agree with the proposed mechanism. SSEN assessed several options under current regulatory arrangements, including awaiting industry change and submitting an enduring code modification (outlined on page 24 of our main submission document); However, SHE-Transmission not passing on the unique elements of the reinforcement to the ESO is a compliant and relatively simple solution to allow the implementation of the adjusted securities and liabilities proposal given the short duration of the trial.

Attributable works 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 has proposed the option of adjusting attributable liabilities by SHE-Transmission not passing through elements of the attributable cost estimates associated with the submarine element to the ESO. This means the ESO will be using a lower attributable works value in the calculation of customers’ liabilities (whether they have opted for fixed or variable liabilities). This will adjust the securities paid by customers.

This does not require a derogation as the STC, under section 12.1 of schedule 9, allows SHE-Transmission to provide the ESO with attributable works information in a form agreed by SHE-Transmission and the ESO.

**Question 7: Do you agree with our minded-to position to reject Part 2 of the derogation request, as it imposes additional risk on all consumers and gives some connection customers an unfair advantage?**

SSEN disagrees with Ofgem’s minded-to position to reject Part 2 of the derogation request. We do not agree that it imposes additional risk on all consumers or gives some connection customers an unfair advantage for the following reasons:

- **Provides a level playing field and reduces the obstacle to connection:** As outlined in our response to question 4 and 5 above, the AA would not create an unfair competitive advantage. Rather the adjustment will provide a more level playing field for Orkney

customers to enter into the market. Securities and liabilities for Orkney customers are around 4.5 times higher than for similar customers on the North of Scotland mainland. This continues to be a significant upfront barrier to connection for projects, particularly smaller or community based projects. As noted in response to Q5, some have indicated they plan to secure planning permission to help reduce securities to a bearable amount and help address current distortions.

- **Does not impose an additional unnecessary risk to the GB consumer:** SSEN views the incremental risk and the probability of the risk materialising to be low as securities would still be at a level to incentivise the developer to continue to completion. Given there will still be an incentive for connection there is no material additional risk that GB consumers would face because of alternative securities and liabilities arrangements.
- **Provide an appropriate mechanism for implementation:** Ofgem have outlined in its minded to rejection that any change to securities and liabilities is sought through the standard industry code modification process. At the same time Ofgem have published another consultation on the significant code review and access and future charging arrangements for connection. SSEN does not agree that changes to the securities and liabilities can be sought now through the standard industry code modification process due to the nature of the changes being applicable only to Orkney customers and on a trial basis, at the same time as wider ongoing industry code reviews (including Ofgem's significant code review and energy code review). SSEN proposed a trial approach to both mitigate risks associated with unintended consequences and to feed any learning from the trial into any wider industry code reviews; to seek change via the standard industry process would be counterproductive.

#### **Updated Orkney programme and Energisation date**

The connection energisation date for the Orkney project has recently been extended from October 2022 to April 2023 due to a delay in the overall project programme (please see our response to the needs case consultation for further information). This in turn has moved the 'trigger date' for securities and liabilities from April 2019 to April 2020. We welcome separate discussion with Ofgem with regards to the timeline for the AA and relevant derogations.