Highlands and Islands Enterprise
Iomairt na Gàidhealtachd 's nan Eilean

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Dear Sir/Madam

Consultation: CMP 324 and 325

Thank you for the opportunity to respond to the above consultation.

Highlands & 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 – for many years have sought to influence grid regulatory matters to ensure the interests of our region are taken into account. HIE and its partners also work closely with Scottish Government in relation to grid regulation and investment.

The Highlands and the Islands off the north and west coast of Scotland 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 generation – from small scale, community developments to very large commercial installations – and has significant opportunity to further develop its renewable resource. The current charging regime has long been a concern for us and we absolutely support any measures which could reduce the cost of accessing and using the system for developers across the Highlands and Islands. We are therefore supportive of the Original proposal given that it would result in slightly reduced TNUoS charges for our region.

Our detailed comments are set out in the attached.

Yours sincerely

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1. **Do you believe that the CMP324 and CMP325 Original Proposal better facilitates the Applicable CUSC Objectives?**

Yes, HIE agrees that the original proposal better facilitates the applicable CUSC objectives and strongly supports this solution compared to others raised by the Working Group: Retail Price Index (RPI) zones and the Electricity Ten Year Statement (ETYS) zones.

In particular, aligning generation and demand zones better facilitates effective competition in the generation and supply of electricity, because it reduces generation Transmission Network and Use of System (TNUoS) tariffs in the north of Scotland. National Grid Electricity System Operator's (NGESO) analysis (Annex 9) provides the mean average £/MWkm as £41.54/MWkm, and the original proposal reduces this to £37.75/MWkm. Reducing TNUoS tariffs in the north of Scotland is crucial, because high connection costs and use of system charges currently act as a barrier to new renewable generation, and can ultimately jeopardise energy security and the potential to contribute to Scotland's (and the wider UK's) ambitious climate change mitigation targets.

It is also worth noting that Ofgem rejected aligning Generation and Demand dominated Distribution Use of System (DUoS) zones through DCP137 in 2014 [1], on the grounds that *'there is a strong case not to introduce a highly complex locational charging regime to address generation dominance',* and *'the potentially negative effect that locational charging could have on the simplicity, transparency and predictability of charges'*, and *'the difficulty to quantify the interaction of locational charges with other energy policies (eg. Reducing generation growth, even in demand-led areas)'.* Although this is related to the distribution charging methodology, the concept is the same and it is important to learn from this outcome in order to progress this modification.

In terms of investment, H&Is developers have experienced first-hand the difficulties of forecasting TNUoS charges against the backdrop of continued uncertainty surrounding the method of calculation and potential future volatility. The original proposal provides 'stability' as discussed further in Question 5.

2. **Do you support the proposed implementation approach?**

Yes, we agree that it is important that a decision is reached in order to be implemented at the start of the RIIO-2 price control period to allow certainty for developers.

3. **Do you have any other comments?**

The CUSC clauses around the Boundary Sharing Factor (BSF) are outdated and need reviewed. Section 3.37 of the consultation document states that *'the sharing factor calculations in the current methodology would stay the same under the original solution'.*

We believe there is a possible defect, in that CUSC section 14.15.53 (on calculating boundary sharing factors) does not account for the three types of generation, only conventional and low carbon. The BSF equation should be aligned with the outcomes of CMP268 *'Recognition of sharing by Conventional Carbon plant of Not-Shared Year-Round circuits'* to account for intermittent generation. This could see a slight change in TNUoS charges and may impact on re-zoning.

4. **Do you wish to raise a Workgroup Consultation Alternative Request for the Workgroup to consider?**

- **Treatment of HVDC links**

Each HVDC link will have its own individual Expansion Factor, and therefore the impact of HVDC remains uncertain and unsolved. There is volatility and difficulty in getting confidence in current and future tariffs. This is exemplified in National Grid's report *'Forecast TNUoS tariffs from 2016/17 to 2019/20'* [2], which is an insightful report that shows tariffs with and without the Caithness-Moray HVDC link, and the Western HVDC Link. Since HVDC links can significantly impact on TNUoS tariffs, and to that end zoning, we suggest that the treatment of HVDC links should be incorporated into the scope of CMP324/325. This is due to our concern that remote island connections could significantly increase average charges in the north of Scotland as nodal charges on islands tend to be higher, and the treatment of HVDC links remains uncertain and unclarified in the CUSC. Furthermore, the outcomes of CMP303 *'Improving local circuit charge cost reflectivity'* and CMP320 *'Island MITS Radial Link Security Factor'* are pending, creating further uncertainty.

5. **What are your views on the potential solutions discussed in the report? Please provide any evidence or rationale for your preferred solution.**

HIE supports the original proposal, to align the generation and demand zones. At present, the 27-zone model utilised to assess charging could be viewed as being unfairly skewed to favour generators in the south, where generators are effectively paid to use the system. This modification seeks to find a balance.

An advantage of the original proposal is 'stability', in that there would be no need to re-zone at the beginning of each Price Control period. Potential investors are already sensitive to the impact and risk associated with TNUoS, with recent changes to TNUoS charges already having a significant impact on the cost effectiveness of power projects in low demand zones.

Furthermore, under current arrangements for lower voltage areas like Scotland, the unit costs of circuits are high, and therefore, a single generator connection would constitute a zone in itself. NGESO would therefore need to apply a zonal tariff to that single generator, which is not an efficient method and also creates uncertainty which could be detrimental to investment decisions. This proposal is therefore positive, in that it provides certainty for investors in terms of TNUoS tariff settings.

The results from the ETYS zones is almost identical to the original proposal, but we agree that this method is less practical, given the number of ETYS zones and the methodology required to merge zones. There is also less stability with this solution, as ETYS zones are reviewed annually and rezoning between price controls may create a 'shock' to generator's whose charges may change significantly due to moving to a new zone between price controls.

The alternative 'RPI' zones would significantly increase TNUoS charges in the north of Scotland, and we therefore do not support this solution. We would also question why this solution would be indexed by 'RPI' instead of Consumer Price Index (CPI), since Ofgem appear to be moving away from using RPI as the inflation index in other sectors.

6. **What are your views on the distributional effects of the potential solutions outlined? Please provide your rationale.**

We are aware of the distributional effects related to the original proposal. Aligning the 27 zone generation model with the 14 zone demand model would not only add some clarity to the charging, but based upon the initial results published by the panel, would see a small reduction in TNUoS charges for generators in the north of Scotland. Overall, we support the original proposal over the current arrangements.

References

[1] Office of Gas and Electricity Markets, "Distribution Connection and Use of System Agreement (DCUSA) DCP137", 11 Feburary 2015.

[2] National Grid Electricity System Operator, "Forecast TNUoS tariffs from 2016/2017 to 2019/2020", 28 January 2015.