

Nicola Medalova
Head of Market Change
National Grid
Gallows Hill
Warwick
CV34 6DA

30 June 2017

Dear Nicola

Open letter consultation: Investment Ahead of TEC Guidance Document

I refer to your letter of 1 June 2017 inviting comments on proposed revisions to the Investment Ahead of TEC Guidance Document (the Guidance). We use the term 'delay' and 'delay charges' throughout as it is the better understood term for what the Guidance now refers to as "recovery of transmission investment costs which become inefficient".

We do not oppose delay charges in principle and agree that there will be circumstances where they are appropriate. However, as set out in this letter, we have three major concerns about the current arrangements for delay charges:

- a) There is a lack of structure and process around the reporting and communication of commercial decisions points which may result in inefficient decision making, and delay costs being incurred unnecessarily.
- b) Given the significant commercial implications of delay charges and the wider regulatory framework, they must be provided for in the CUSC and subject to the CUSC governance process, not in ad hoc guidance. Until this is done, NGET will have no valid basis to levy delay charges.
- c) The current explanation of how delay charges are derived contains insufficient detail to demonstrate that the charges meet the cost-reflectivity and transparency requirements of the CUSC.

In order to minimise the cost to consumers, inefficient transmission investment should be avoided. It is therefore essential that Transmission System Owners (TOs), the System Operator (the SO), and developers of generation projects (generators), work together to achieve this objective.

The need for a more structured process

There is a lack of structure and process in the commercial interactions between TOs, SO and generators, which means that it is not sufficiently clear at each stage how a generator might be exposed to delay charges. This can lead to inefficient decision making and costs being incurred unnecessarily. It is essential that an appropriate process is established and key commercial checkpoints defined within the CUSC. As a minimum, we believe the following steps should be provided for:

- *Regular discussion between generators, TOs and the SO:* TOs, the SO and generators should be required to liaise regularly so that each party is aware of the others' current timetables and the TOs' spending profiles. This will give generators forward visibility of the point at which the TO is likely to seek formal agreement to proceed with expenditure.
- *Agreement to proceed when the TO is about to incur material costs:* When a project reaches a stage that involves material expenditure by a TO, the generator should be given the opportunity to confirm that it wants the programme to proceed according to the existing timetable. If it does so, it accepts that it may subsequently become liable for delay charges (which should be set out in transparent and unambiguous terms). If the generator declines to proceed, it would avoid liability for delay charges but may suffer consequences in terms of previously agreed milestones (which again, should be clearly set out).

In our experience some TOs are already mitigating risks in this way and we believe it should be common practice across all TOs. If these steps are followed they would significantly reduce the risk of inefficient spend.

Delay charges need to be provided for within the CUSC

In our view delay charges should only be levied by NGET if their basis of calculation is clearly set out in the CUSC rather than an ad-hoc guidance document, as proposed here, which has no force and insufficient governance regarding its modification. The CUSC currently makes no provision for NGET to impose the delay charges provided for in the Guidance. As a priority, therefore, before any delay charges are levied in accordance with the Guidance, the CUSC must be amended. This is a material change that should be made through the formal CUSC modification process.

Demonstrating cost reflectivity and comments on draft Guidance

We have provided detailed comments on the draft Guidance in Annex 1 to this letter. Our main comments relate to the basis of calculation of delay charges, in particular:

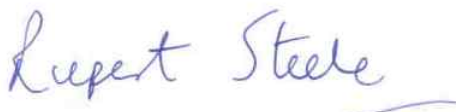
- There needs to be a clearer explanation of how the proposed delay charges reflect the actual costs incurred by the TOs.
- Any charges must be transparent (as required by SLC 6(4)).

We do not believe the current Guidance meets these requirements and we consider that further work is needed to address these points before delay charges are introduced.

We have also attached a track changes version of the draft guidance compared against the current guidance. As and when valid final guidance is produced, it would be helpful if NGET published a track changes version so that industry participants can see the changes that have been made.

We assume that all consultation responses will be published and emphasise that we are keen to work with NGET and the wider industry on this topic.

Yours sincerely,



Rupert Steele
Director of Regulation

**INVESTMENT AHEAD OF TEC GUIDANCE DOCUMENT
SCOTTISHPOWER DETAILED COMMENTS ON THE OPEN LETTER**

- Transmission charges must be cost reflective. To date we have not seen a clear explanation from NGET of the basis for the estimation of the TO's loss. Nor have we seen anything that explains how the proposed charge reflects the TO's loss. At present it is not possible to judge or to demonstrate that the charges are cost reflective.
- The CUSC must be modified to allow for delay charges.
- Delay charges are a material change to the existing framework. Detailed proposals for the introduction of delay charges must be considered against the CUSC objectives and in accordance with the CUSC Modification Procedure. Such a change would require Ofgem approval.

Responses to questions	
Question	ScottishPower comment
1	<p>Do you agree with the principle that inefficient costs related to early transmission investment, which occurs as a result of a generator request, should be recovered from the generator who makes the request?</p> <p>In some circumstances it may be appropriate for a generator to bear such costs. However at present the Guidance and wider background is too unclear for us to make any form of definitive judgment. Issues that need to be addressed include the following.</p> <p>What is the TO's loss?</p> <p>Transmission charges must be cost reflective. To date we have not seen a clear and cogent explanation from NGET of the actual cause and source of the TO's loss resulting from delays, and why this is not recoverable under the RIIO price control arrangements.</p> <p>In the ordinary course, a TO will take its investment decisions on the basis that the investment will be remunerated via the RIIO arrangements. In particular, it will obtain: (i) full regulatory depreciation for the investment; and (ii) its cost of capital. It may also obtain additional revenues from the various RIIO incentive arrangements. The price control allows TOs to finance their licensed activities (including financing investment).</p> <p>It is not clear how the TO's loss arises against this background. This needs to be set out clearly, with reference to the price control framework.</p> <p>We understand from the cover letter that NGET has recently spent time working to better understand the impact felt by TOs in this regard, and so we expect that NGET will provide a full explanation of TO loss.</p> <p>Against this background it is impossible at this stage to say that the proposed charges are cost reflective.</p>

Responses to questions	
Question	ScottishPower comment
	<p>The critical importance of transparency and generator consent</p> <p>If a generator is to be liable for delay charges as a result of inefficient investment, it is essential that the generator agrees to the relevant works proceeding <u>before</u> they are undertaken.</p> <p>Importance of a CUSC modification/ wider policy must be subject to a full impact assessment</p> <p>At present NGET is not entitled to levy delay charges – the CUSC does not provide for such charges. The Guidance is not approved by Ofgem. The introduction of delay charges would be a material change. Accordingly it is essential that detailed proposals are carefully assessed against the applicable CUSC objectives. Following the CUSC modification procedure (including approval by Ofgem), is essential to ensure robust scrutiny with full consultation.</p> <p>New generation projects carry significant risks and costs and include a range of factors over which a generator has no control such as changes in energy policy, e.g. to the CfD regime and delay to transmission works, not caused by the generator, causing delay to connection.</p> <p>All of these events can lead to delay and termination of new generation projects, and all can cause significant costs to generators. In the ordinary course, generators do not wish to delay: it leads to loss of revenue. The regulatory regime discourages delay, as an example the CfD includes robust delivery obligations. Often delay is caused by external factors that are well beyond the control of the generator.</p> <p>If there are delays to transmission works which are caused by the TO or SO, the generator has very limited recourse against the TOs and the SO.¹ The generator bears its own costs created by that TO or SO caused delay. These costs can be significant. The same applies to no fault delays to transmission works. It should also be noted that generators are exposed to significant cancellation charges under CMP 192.</p>
2	<p>What are your views on the changes we are proposing to the guidance note and methodologies?</p> <p>We make the following high level comments in this regard.</p> <p>A CUSC modification is required</p> <p>SLC6(4) provides that NGET shall: <i>“...prepare a statement approved by the Authority of the connection charging methodology”</i> That statement is now contained in the CUSC. SLC C6(4) provides that the statement (i.e. the relevant provisions of the CUSC): <i>“shall be in such form and in such detail as shall be necessary to enable any person to determine that the charges to which he would become liable for the provision of such services are in accordance with such statement.”</i></p>

¹ Save for limited liquidated damages which we understand rarely apply.

Responses to questions	
Question	ScottishPower comment
	<p>CUSC 14.4 cannot be read as providing for the charges contemplated in the Guidance. Until a modification is approved and incorporated into the CUSC, there continues to be no proper basis in the CUSC for the charges contemplated in the Guidance.</p> <p>Transition</p> <p>Any change to the CUSC must be prospective and be accompanied by an appropriate transition plan to enable generators to restate their programme dates with no liability for delay charges for such restatement.</p>
3	<p>What are your views on the benefits of publishing separate guidance notes for each of the two charges currently outlined in the guidance document?</p> <p>This response focusses primarily on delay charges and as set out above we believe the basis of their calculation should be set out in the CUSC to have force, not in a guidance note.</p> <p>The provision of backfeed engages different issues to delay, and the fact that both issues are addressed in the same document creates a risk that the two issues are wrongly conflated.</p> <p>We are unconvinced that the proposed backfeed charges are appropriate, cost reflective or allowable under current CUSC arrangements. We do not believe that delay charges should be applied in a similar manner as backfeed. There are a number of reasons why they are different:</p> <ul style="list-style-type: none"> • Backfeed is essential to provide power for the construction of new power stations. • Backfeed is provided by the same assets that provide TEC on and after commissioning. This represents a very efficient outcome for consumers, as it avoids the material costs of the construction of alternative backfeeds that would only be required for a very short period of time, in many cases less than three years. • Whilst the backfeed is operational, the generator becomes liable for TNUoS, on the same basis as other users of the system. An additional backfeed charge for developers of interconnectors and power stations would be discriminatory as it involves an element of double charging. • A separate charge for backfeed creates a further cost for new power plants and interconnectors and a further barrier to entry. It does not facilitate competition in generation. • Backfeed timescales can be estimated at the start of a project whereas delays are normally caused by external factors.

Responses to questions	
Question	ScottishPower comment
	<ul style="list-style-type: none"> Where earlier backfeed dates are required they are often driven by the TO to align with seasonal outage restrictions and the development of the offshore user works programme <p>In all the circumstances the two issues should be considered separately, however many of the same questions around actual TO loss also fall to be addressed in this context.</p>
4	<p>Are there any further changes you would like to see made to the guidance note?</p> <p>We make various paragraph by paragraph comments below. We raise a set of issues in this response that are fundamental to the basic question as to whether delay charges are appropriate in the first place. Until these are addressed, and the CUSC is modified, it is not possible to say that the Guidance is appropriate or fit for purpose.</p>

Clause by clause comments on guidance	
Para	Comment
2.2	<p>Change requested by the generator</p> <p>The Guidance refers to inefficient investment as a result of “<i>Where a customer makes a change to the connection date</i>”. However in our experience, inefficient investment has resulted from the TO investing well in advance of what would be required to meet an original agreed connection date and before any changes to connection dates have been discussed. Notwithstanding, it is essential that generators are put in a position to make informed choices. This means that there must be a significant degree of transparency about the timing of TO investment decisions and the potential impact of these decisions on the generator if there is a delay.</p> <p>In this regard the existing Construction Agreements and TOCAs create a framework for regular communication and reporting between generators, NGET and the TOs. This system should be operated in a way that ensures that the generator’s consent is obtained prior to expenditure being incurred. In our experience some TOs are much more transparent and pro-active in communicating any anticipatory investments than others.</p> <p>Such consultation is essential in making a sound decision about investment. It is well known that there are a range of contingencies around generation projects, for example, offshore wind projects are not likely to proceed until they have a CfD and CCGT projects will often be contingent on an award in the Capacity Auction. Planning approval is another factor. It is therefore essential to make investment decisions after consultation with the developer. Failure to do so risks inefficient investment on the part of the SO, which is not driven by generator need.</p> <p>The wider regulatory framework seeks to ensure that generators are treated fairly, by regulating the TOs’ monopoly position. Making investments without</p>

Clause by clause comments on guidance

Para	Comment
	<p>adequate (or any) consultation, and then seeking to recover any part of the costs from the generator would engage wider regulatory issues.</p> <p>What criteria are applied to determine whether an investment has become inefficient?</p> <p>The Guidance says that a charge may be applicable when a generator changes a connection date and the result is <i>“the timing of network investment becoming inefficient”</i>. How do the TO and NGET decide that network investment has become inefficient? What criteria apply?</p> <p>When a TO takes a decision to invest it does not have perfect foresight. It will therefore take into account that delays may be possible in the future and it is able to mitigate these risks by consulting with the generators. It follows that the fact that there is a delay to the connection date cannot of itself mean that the investment has become inefficient or that the initial decision that the investment was efficient has somehow become wrong.</p> <p>Further, the delay cannot be viewed in isolation. It may have been more efficient to progress with the works in any event, for example because the relevant works form part of a wider package of works for procurement purposes or because progressing the works is efficient from an outage management perspective.</p>
2.2.	<p>Any charges arising from the delay <i>“will be outlined in the resulting modification offer”</i>. Charges and the spending profile for a project should be outlined well before the modification offer is made and should, in fact, be clear from the first connection offer. Following the first connection offer, any changes to the charges outlined should be discussed in a transparent manner with the generator. Six monthly statements of prospective delay charges and spend profiles should be provided. It should be possible to specify in advance on a regular basis the charges that will arise due to delays.</p>
3.1. 3.2.2.	<p>Quantum of loss: timing of financing costs</p> <p>The Guidance does not explain how the duration of the delay is assessed bar a general reference to the construction programme at 3.2.2. More detail is required. As an example, there is no clear explanation as to how the start and end dates for finance costs have been chosen and how they link to the TO's actual loss.</p>
3.2.2.	<p>This provides that <i>“if the original construction programme would have been the same regardless of the revised connection date, no financing costs will be recovered.”</i> This emphasises the need for the TO to assess whether the delay has caused the TO any loss. The Guidance should specify how this is assessed according to clear and objective criteria.</p>
3.2.4	<p>The criteria for deciding whether it is practicable to suspend an investment have been deleted (please see deleted 3.2.7). However the factors canvassed at deleted 3.2.7 are also relevant to assessing whether there has been any loss to the TO.</p>
3.2.5.	<p>We assume that this falls to be read with 3.2.2. and that charges will not be levied if it remains efficient to carry on with the investment even though there has been a delay.</p>
3.2.6	<p>The expenditure should be agreed by the generator before it is incurred.</p>

Clause by clause comments on guidance

Para	Comment
3.2.8.	We do not understand how bullet point two is meant to operate. More widely the charges faced by a delaying generator may depend significantly on the number of other generators who will use the new assets, something that could fluctuate, and is beyond the generator's control. This will make charges hard to predict and arbitrary. There is a clear discrimination issue here, as a user with sole use works will likely be much more exposed to delay charges when compared to a user with shared Enabling Works.
4	We do not focus on backfeed in this consultation. However it is not obvious to us why backfeed charges are levied, when a user will also be liable for demand TNUoS whilst the backfeed is operational. Nor is the basis of this charge obvious.
5	There is a need for much greater transparency as regards potential liabilities for delay charges. A generator should be able to ascertain these with certainty at any time. This provision does not go far enough in this regard.

ScottishPower
30 June 2017