



Shetland Islands Council

REPORT

To: Special Shetland Islands Council

06 July 2005

From: Principal Development Officer

DV024-F

Viking Windfarm

Memorandum of Understanding – Between Viking Energy Ltd and Scottish and Southern Energy plc

1.0 Introduction

- 1.1 Today marks an historic moment in the development of a new industry in Shetland.
- 1.2 This report seeks the Council's formal endorsement of the signing of a Memorandum of Understanding between Shetland's Viking Energy Ltd and Scottish and Southern Energy plc. Viking Energy Ltd is the company formed to represent Shetland Islands Council's interests in large-scale wind energy development in Shetland.
- 1.3 The signing will be a significant milestone in creating an investment opportunity for this community based on Europe's best wind resource.
- 1.4 The signing will also mark a significant milestone in creating the circumstances where an electricity interconnector between Shetland and the UK grid can become a reality.

2.0 Background

- 2.1 The proposed Viking windfarm is a project built upon the very substantial business opportunity which Shetland's world class wind resource can provide.
- 2.2 The project concept and details of how a renewables industry might be developed in Shetland were initially presented to Members at Special Executive Committee and Full Council

meetings in September 2003. The report also considered how the case could be built for an interconnector, between Shetland and the UK National Grid.

- 2.3 Things have progressed well since. Staff and financial resources have been committed to the project as and when required by the Executive Committee. This means that what was merely a concept a short time ago is well on the way to providing a very significant financial opportunity for Shetland. It is the intention to present the project to the Shetland public in the near future to raise public awareness and to answer the many questions people are bound to have. This will be a central part of the EIA and an inclusive planning process.

3.0 Link To Council Priorities

- 3.1 This project is a key pillar in the Council's plans to develop the renewable energy sector in Shetland and obtain a national electricity grid connection.

Sustainable Economic Development and Economic Diversification are priorities in the Council's Corporate Plan and are an exact fit with the development aims of this project and this economic sector.

4.0 Partnership

- 4.1 Since the very earliest days it has been envisaged that a strategic partner, with specific expertise in the renewable energy sector, would be required to take this project forward and lend to it the credibility necessary for a project of this magnitude and risk.
- 4.2 An extended partnership selection process has been followed. The criteria used for selection boil down to who is felt to be best placed to help deliver wind farm developments here in Shetland, at the best value possible for the local community. Also, equally crucially, which potential partner is likely to deliver the most clout in obtaining an interconnector for Shetland to the UK Grid.
- 4.3 Negotiations have taken place with four very large public electricity suppliers. It is fair to say that all these parties expressed keen interest, had something to offer and recognised the world-class wind resource Shetland has. They also, all, well appreciated the challenges facing Shetland in gaining a connection to the National Grid.
- 4.4 At the end of a difficult selection process Scottish and Southern Energy plc (SSE) emerged as a clear and logical partner for Viking Energy Ltd.
- 4.5 Reasons for choosing SSE include:

- Financial stability
- Strategic Vision
- Local Shetland Knowledge
- Development Expertise
- Detailed Knowledge of Grid/Transmission Issues
- An Existing Shetland Wind farm Project
- An Existing Application to Connect a Shetland Project to the National Grid
- Strong Interest in a Joint Project at the Highest Level in SSE
- Flexibility and Lateral Thinking in Developing a Shared Vision of a Unique Project

5.0 Why Is Partnership Important?

- 5.1 The September 2003 report stated “The overall investment process may take anything from 8 – 10 years to complete. The signal is clear that to obtain access to capacity in the Scottish Grid, we need to apply to connect a critical mass of realistic, onshore wind projects, from Shetland within months. Serious long term investment decisions need to be made on transmission capacity and it is crucial that Shetland’s requirements are fully considered as part of this process”.
- 5.2 The result of the above is that Viking Energy Ltd is now in the grid connection queue. SSE (Generation) has now obtained a connection offer from National Grid for its Shetland project. Viking Energy Ltd will receive its connection offer in October 2005. The Viking project will face exactly the same challenge as SSE and both need the critical mass of each others’ generation project to help the cable economics.
- 5.3 The connection offer is a document with wide reaching financial consequences. It is crucial to share in SSE’s expert understanding and if things progress as planned ultimately spread the financial risk which obtaining a connection will entail. Acceptance of the connection offer is likely to commit Shetland project developers, Viking Energy Ltd (and the Council as its financial guarantor) included, to offsetting the full development cost of a cable between Shetland and the mainland, until its construction is complete. Thereafter, there will need to be a commitment to pay an ongoing “use of system charge”, effectively a mortgage charge to pay for the cable. However, it is not yet known what that charge will be and whether the Government will “cap” it in a meaningful way. The big risks on the cable should only kick in as it is developed, but everyone should be aware of the likely costs and risk and try to mitigate these where possible.

- 5.4 Members will be aware of the high profile visit that Sir John Mogg, the chairman of Ofgem made to Shetland in 2004. This was part of an ongoing process of engagement with key players regarding the connection. The clear message of that visit is that Shetland won't get a cable unless it is economically justified to Ofgem. The critical tests are can windfarm projects gain planning consents and can they obtain financial backing? Financial backing on such a scale is not obtained without a watertight economic case.
- 5.5 Having a partner with industry reputation, financial clout and proven development expertise should help to build the credibility Viking Energy Ltd and the Viking windfarm project needs. In short it will help to deliver the two keys to making a windfarm happen ie. planning consent and obtaining the large sums to finance the project.
- 5.6 Both parties require the support of the Shetland community and need to take the community with them at all stages. SSE will require Shetland's financial ability to share risks and Shetland's local knowledge to deliver a joint project based on the islands' world class wind resource.
- 5.7 Without SSE, given many factors, (not least the massive queue for grid connections from potential developers throughout Scotland), it is likely that the Viking windfarm project, at least as presently envisaged, won't materialise.
- 5.8 What is also likely is that without Viking Energy Ltd, SSE's project in Shetland won't gain momentum either and a mutually beneficial opportunity for both sides could be lost.

6.0 The MOU

- 6.1 The Memorandum of Understanding (MOU) document sets an extendable 12 month framework to allow closer ties and working arrangements to develop. It is hoped that during these 12 months the circumstances will be put in place to enable a mutually beneficial joint venture to be formally created.
- 6.2 The MOU document is attached as Appendix 1 which contains confidential, commercial information.
- 6.3 Wind energy is a highly lucrative business due to an incentivised market place but that market, like any other comes with barriers to entry and financial and technical risks. Viking Energy Ltd is now entering into a phase of the project where it will face real challenges and real financial risks in reaching its goal.
- 6.4 It is pragmatic and makes good commercial sense to pool knowledge and expertise. Sharing the risks and challenges

ahead should help to further both sides' goal of reaping the commercial benefits of Shetland's world class resources.

7.0 Practical Implications of the MOU

- 7.1 The MOU is geared to ultimately making the development of two wind farm projects in Shetland ie. Viking Energy Ltd (300Mw) and SSE (250Mw) into one 550Mw (possibly up to 600Mw) project. It sets the basis for the negotiation of a formal joint venture. If it succeeds:
- 7.2 The development challenges become a single set of issues.
- 7.3 The bird study and EIA work becomes one.
- 7.4 The public consultation/information process becomes one.
- 7.5 Subject to National Grid approval the connection application becomes one, with one set of risks and challenges.
- 7.6 What was a fledgling concept and little more than an aspiration two years ago becomes a focussed, very serious, practical project eg. Wind data analysis, analysis of turbine locations, financial requirements, due diligence and so on, all become one.
- 7.7 A single, focussed, approach on transmission charging and on the sanctioning of the required investment in the subsea cable is developed.
- 7.8 Ownership and trading interests for both sides are identified and protected within the MOU framework.
- 7.9 The signing of the MOU document will represent a significant leap forward for Viking Energy Ltd, for SSE and for Shetland in translating Europe's best wind resources into a large scale, commercial opportunity.
- 7.10 The signing of the MOU is a significant milestone on a par with similar stages in the build up to the development of Sullom Voe Oil Terminal in Shetland. It is something to celebrate and it is something to build confidence that through Shetland Islands Council and Viking Energy Ltd, the Shetland community can take this development and lead this development, the whole way. The clear aim is to diversify and help secure a sustainable economic future for the islands.

8.0 Financial Implications

- 8.1 No financial implications directly arise from this report. The wider Viking windfarm project, and possible joint venture, has

considerable financial implications, and these will be reported for decisions as they arise.

9.0 Policy and Delegated Authority

- 9.1 The work to implement the Viking windfarm project and support Viking Energy Ltd is being done in relation to the following Economic Development Policy:

Encouraging the development of a renewable energy sector in Shetland including ancillary manufacturing and maintenance.
The policy was adopted as part of the Economic Policy Statement by the Executive Committee on 9 December 2003 (Min. Ref. 34/03) and by the Council on 17 December 2003 (Min. Ref. 161/03)

- 9.2 The Executive Committee has delegated authority to deal with project specific issues, leaving the Council free to deal with broad strategy and planning considerations (SIC Min. Ref. 135/03)
- 8.3 In this instance this report is brought before the full Council due to time pressures created by the Council's summer recess and the need to maintain overall project momentum.

10.0 Observations

- 10.1 The signing of the MOU document as contained in confidential appendix 1 is a significant milestone in creating an investment opportunity for this community based on Shetland's world-class wind resource.
- 10.2 The signing of the document will also be a significant milestone in creating the circumstances where an electricity interconnector between Shetland and the UK grid can become a reality.
- 10.3 Shetland Islands Council is the majority shareholder in Viking Energy Ltd and holds authority over the actions and commitments of that company.
- 10.4 On 30 March 2005 Councillors Drew Ratter, Bill Manson and the Chief Executive or his appointee(s) were approved by the Council as a negotiating team for the discussion of the MOU with SSE on behalf of Viking Energy Ltd (Ref: 68/05).

11.0 Recommendations

- 11.1 That Members endorse the signing of the MOU by Councillor Ratter and Councillor Manson on behalf of Viking Energy Ltd.

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