

Consultation

Shetland HVDC Link - Project Assessment

Publication date: 03 September 2021

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Response deadline: 04 October 2021

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We¹ are consulting on our project assessment of Scottish Hydro Electric Transmission Plc's (SSEN Transmission) Shetland HVDC Link project, and the associated licence modifications required to support the delivery of the project. This is a project under the Large Onshore Transmission Investment (LOTI) re-opener mechanism in the RIIO-2 Price Control Framework. At the project assessment stage, we review and ultimately set revenue and outputs associated with delivery of a LOTI project.

We particularly welcome responses from stakeholders impacted by the project, stakeholders with an interest in the costs of electricity transmission infrastructure, and the transmission owners. We would also welcome responses from other stakeholders and the public.

This document outlines the scope, purpose, and questions of the consultation and how you can get involved. Once the consultation is closed, we will consider all responses. We want to be transparent in our consultations. We will publish the non-confidential responses we receive alongside a decision on next steps on our website

¹ The terms 'Ofgem', 'the Authority', 'we' and 'us' are used interchangeably in this document.

at [Ofgem.gov.uk/consultations](https://www.ofgem.gov.uk/consultations). If you want your response – in whole or in part – to be considered confidential, please tell us in your response and explain why. Please clearly mark the parts of your response that you consider to be confidential, and if possible, put the confidential material in separate appendices to your response.

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Executive Summary

Summary of consultation position

In November 2020, we received a 'Project Assessment' submission from SSEN Transmission, for its proposed Shetland HVDC Link project (the Shetland Link). The project will provide an electricity transmission connection between the Scottish mainland and the Shetland Isles.

This consultation is seeking stakeholder views on our proposed efficient cost allowances for the Shetland Link, as well as our proposed modifications to SSEN Transmission's licence to support delivery of the project.

The link will be a 600MW single circuit connection that serves the dual purpose of exporting renewable generation from windfarms on and around the Shetland Isles to the mainland and providing a new secure supply connection to Shetland as the Lerwick Power Station reaches its end of life.

SSEN Transmission submitted its initial costs for delivering the Shetland Link to Ofgem in November 2020, amounting to £657.8m². As discussed and agreed with us, it provided further updates to those costs in May and August 2021, bringing the costs to £675.4m. We are minded to provide an ex-ante³ allowance of costs of £628.6m for delivery of the project, which constitutes a reduction of £46.8m (6.9%) to SSEN Transmission's submitted costs. This proposed reduction is the result of our careful review of SSEN Transmission's submitted costs over the past eight months, including benchmarking those costs against similar projects and our detailed assessment of SSEN Transmission's contracting and risk management strategy.

The proposed reduction is primarily comprised of the following elements:

- Work packages and activities⁴: We are minded not to allow £16.4m of cost relating to planning and consent, engineering, and construction.
- Risk: We are minded not to allow £30.3m in the ex-ante allowance relating to general project risk, Covid risk and Brexit risk. We are minded to make a provision within the

² Excluding cyber security costs which have been excluded from this project assessment.

³Upfront project allowances – excluding additional allowances for example from cost and output adjusting events.

⁴ The following cost categories: Regulation and Consent, Engineering, Construction, Commissioning, Operations, Insurance and Other.

cost and output adjusting event (COAE) mechanism for SSEN Transmission to submit additional justified funding requests relating to Covid risk, as well as certain other risks (should the cost exceed a certain threshold).

We provide a high-level summary table of proposed allowances below and additional details regarding these proposed reductions in chapter 2 of this document.

High level summary of our proposed cost allowances for the Shetland Link project

Cost Area	Submitted Cost (£m)	Proposed Adjustment (£)	Proposed Allowance (£)
Project Management	45.4	0.0	45.4
Work Packages/Activities	561.5	-16.4	545.1
Risk	68.6	-30.3	38.3
Total	675.4⁵	-46.8	628.6

Interaction with Opex Escalator mechanism

In our RIIO-2 framework, we introduced the Opex Escalator mechanism, a method by which the closely associated indirect (CAI) costs and network operating costs (NOCs) of a relevant project are automatically calculated based on the efficient direct capex of the project. We decided in our Final Determination⁶ for the electricity transmission sector that this mechanism would apply to LOTI re-opener projects.

Having reviewed the nature of the relevant costs of LOTI re-opener projects, we now intend to move the funding for CAI costs and NOCs for LOTI projects from the Opex Escalator mechanism to be assessed under LOTI re-opener. Our approach to the project assessment of the Shetland link reflects this intention, i.e., the scope of this project assessment includes CAI costs and NOCs, and these costs will be funded via the LOTI mechanism rather than the Opex Escalator mechanism. We are consulting separately on our proposal to change the Opex Escalator mechanism because the change will apply to all ET licensees. Additional details on that proposal and consultation are provided in paragraphs 2.30-2.32 of this document.

⁵ Totals may not sum up due to rounding

⁶RIIO-2 Final Determinations: <https://www.ofgem.gov.uk/publications/riio-2-final-determinations-transmission-and-gas-distribution-network-companies-and-electricity-system-operator>

Next Steps

After considering responses to this consultation, we will conclude our project assessment of the Shetland Link with a decision. That decision will follow our decision on modification to the Opex Escalator licence condition, and we will endeavour to publish both decisions by November 2021. We will also issue our decision on the proposed modifications required to SSEN Transmission's licence to support delivery of the Shetland Link.

1. Introduction

What are we consulting on?

1.1. This consultation sets out our proposals and seeks stakeholder views on the project assessment of the Shetland Link in the following areas:

1.1.1. Our initial assessment of the efficient costs that we are minded to allow SSEN Transmission to recover from consumers for delivery of the Shetland Link.

1.1.2. Our proposed outputs and delivery date for the Shetland Link.

1.1.3. Our proposed modifications to SSEN Transmission’s licence required as part of the implementation of the Shetland Link project. The notice of the proposed modifications, required in accordance with section 11A of the Electricity Act 1989 (“the Act”), is provided at Appendix 2.

The proposed modifications include modifications to:

- specify the allowances, outputs and delivery timelines in 1.1.1 and 1.1.2 above.
- amend the definition for SSEN Transmission’s transmission area to include the Shetland Link.
- specify amendments to the COAE and large project delivery (LPD) provisions for the Shetland Link.

Context

Strategic Wider Works and Large Onshore Transmission Investment

1.2. The GB onshore electricity transmission network is planned, constructed, owned and operated by three transmission owners (TOs): NGET in England and Wales, Scottish Power Transmission (SPT) in the south of Scotland, and Scottish Hydro Electric Transmission (SSEN Transmission) in the north of Scotland. We regulate the onshore TOs through the RIIO (Revenue = Incentives + Innovation + Outputs) price control. For offshore transmission, we appoint Offshore Transmission Owners (OFTOs) following competitive tenders.

1.3. In December 2020 we published our RIIO-2 Final Determinations for the three TOs which set out the key elements of the price control from 1 April 2021 to 31 March 2026. This included the replacement of the previous Strategic Wider Works (SWW) arrangements under RIIO-1, for assessing large transmission projects deemed necessary during the price control, with the Large Onshore Transmission Investment (LOTI) re-opener. These newly introduced arrangements are given effect to in the electricity transmission licences of NGET, SSEN Transmission and SPT.

1.4. In a similar implementation to its predecessor, under the LOTI re-opener, TOs have received funding to complete pre-construction works and are able to seek construction funding for specific projects when they consider the need and costs for those projects has become more certain. When a project is brought forward by a TO, Ofgem considers the needs case for the project. If Ofgem approves the need for a project, it will go on to consider the detailed project delivery costs. Subsequently, if Ofgem concludes positively on all aspects of its assessment, it implements its final decision by proposing modifications to the TO's Electricity Transmission licence. Further detail of the LOTI arrangements can be found in the relevant TO's licence and the LOTI Guidance document⁷.

1.5. Our current LOTI re-opener assessment process consists of three main stages:

- Initial Needs Case (INC) – Our opportunity to identify, at an early stage, any concerns we have with how the TO has selected the option it intends to seek planning approval for.
- Final Needs Case (FNC) – Our process for assessing and deciding whether there is a confirmed need for the transmission project. This process includes a robust review of the TO's cost-benefit analysis (CBA) for the project.
- Project Assessment – Our assessment of and decision on the detailed cost estimates and delivery plan in order to set allowed expenditure and required outputs for the transmission project. This stage sets cost allowances for the relevant project which will ultimately be passed on to consumers.

⁷LOTI Guidance: <https://www.ofgem.gov.uk/publications/large-onshore-transmission-investments-loti-re-opener-guidance>

1.6. Ofgem considers whether the needs case, technical scope, and timing of delivery of proposed projects are sufficiently well justified and represent long-term value for money for existing and future customers. As part of this exercise, Ofgem considers costs submitted by TOs in their Project Assessment submissions and, where appropriate and subject to consultation, Ofgem does not allow unreasonable and unjustified costs.

1.7. These costs are subject to the same sharing factor (50% in RIIO-1 and 36% RIIO-2 for SSEN Transmission), tax and inflation treatment, incentives, and cost of capital (i.e., financing costs) as the rest of the RIIO-2 price control.

1.8. The prevailing regulatory arrangements (e.g., incentives, cost of capital etc) under each price control (e.g., RIIO-1, RIIO-2, RIIO-3 etc.) will apply to each LOTI re-opener project.

Background on the Shetland Link

1.9. The Shetland Link is SSEN Transmission's proposed solution for connecting the Shetland Isles to the Scottish mainland. SSEN Transmission is contracted to connect with the Viking Energy Wind Farm (VEWF) by quarter four of 2024. The Shetland Link will extend SSEN Transmission's transmission network and comprises of the following as proposed by SSEN Transmission:

- Construction of a new 132kV AC Gas Insulated (GIS) substation at Upper Kergord, Shetland;
- Construction of a new converter station at Upper Kergord, Shetland;
- +/-320kV 600MW HVDC single circuit cable: 250km subsea and 11km onshore (9km on Shetland and 2km on the Scottish mainland);
- Construction of a new HVDC switching station at Noss Head, Caithness, to form connection to the Caithness-Moray HVDC Link and a north of Scotland HVDC multi-terminal system.

1.10. SSEN Transmission has advised us that the project is currently on schedule to meet its first contracted connection date of December 2024.

1.11. The INC and FNC for the Shetland Link project took place during the RIIO-1 price control. SSEN Transmission submitted its project assessment in November 2020 as a Strategic Wider Works (SWW) re-opener project. However, our assessment has spanned the end of that price control and into the current RIIO-2 price control; and our decision will be made during the current price control. We are therefore undertaking the project assessment of the Shetland Link as a LOTI project in accordance with the requirements of the licence condition and re-opener guidance. As stated in 1.8 above, the prevailing RIIO-2 arrangements apply.

1.12. We published our decision⁸ to approve the FNC for the Shetland Link in July 2020, following consultation. That decision says that:

- there is clear technical need for the reinforcement. Without the Shetland transmission project, VEWf (and other generation projects) would not be able to safely connect to the National Electricity Transmission System due to the lack of transmission capacity in the local area; and
- the link is likely to represent an economic and efficient outcome (in terms of long-term value for money) for existing and future GB consumers. This is because the link, once operational, will ensure long term security of supply on the Shetland Isles at a reasonable cost, whilst also allowing significant levels of low carbon generation to connect to the electricity network that can contribute towards meeting the Net Zero target at the lowest cost to GB consumers.

1.13. Our FNC decision was based on the condition that Ofgem was satisfied, by the end of 2020, that VEWf is likely to go ahead. We received sufficient reassurances from the project developer, Scottish and Southern Renewables (SSER), in July 2020 that VEWf was going ahead.

⁸Shetland Link – Decision on Final Needs Case: <https://www.ofgem.gov.uk/publications/decision-final-needs-case-shetland-electricity-transmission-project>

Related publications

Shetland HVDC Link: Consultation on Proposed Final Needs Case and Delivery Model, June 2020:

<https://www.ofgem.gov.uk/publications/shetland-transmission-project-consultation-proposed-final-needs-case-and-delivery-model>

Shetland HVDC Link: Decision on the Final Needs Case, July 2020:

<https://www.ofgem.gov.uk/publications/decision-final-needs-case-shetland-electricity-transmission-project>

RIO-2 Final Determinations for Transmission and Gas Distribution network companies and the Electricity System Operator, December 2020:

<https://www.ofgem.gov.uk/publications/rio-2-final-determinations-transmission-and-gas-distribution-network-companies-and-electricity-system-operator>

Decision on the proposed modifications to the RIO-2 Transmission, Gas Distribution and Electricity System Operator licences, February 2021:

<https://www.ofgem.gov.uk/publications/decision-proposed-modifications-rio-2-transmission-gas-distribution-and-electricity-system-operator-licences>

Large Onshore Transmission Investments (LOTI) Re-opener Guidance, March 2021:

<https://www.ofgem.gov.uk/publications/large-onshore-transmission-investments-loti-re-opener-guidance> [Shetland publications](#)

Notice of Statutory Consultation to Modify Special Condition 3.36 Opex Escalator for Electricity Transmission, August 2021:

<https://www.ofgem.gov.uk/publications/notice-statutory-consultation-modify-special-condition-336-opex-escalator-electricity-transmission>

Consultation stages

1.14. This consultation will open on 03 September 2021 for 28 days and close on 04 October 2021. We will review and publish the responses 10 days after the consultation closes. We will endeavour to publish our decision by the end of November 2021.

How to respond

1.15. We want to hear from anyone interested in this consultation. Please send your response to James Norman, Head of Electricity Transmission Development at riioelectricitytransmission@ofgem.gov.uk.

1.16. We've asked for your feedback on the specific questions set out throughout this document. Please respond to each one as fully as you can.

1.17. We will publish non-confidential responses on our website at www.ofgem.gov.uk/consultations.

Your response, data and confidentiality

1.18. You can ask us to keep your response, or parts of your response, confidential. We'll respect this, subject to obligations to disclose information, for example, under the Freedom of Information Act 2000, the Environmental Information Regulations 2004, statutory directions, court orders, government regulations or where you give us explicit permission to disclose. If you do want us to keep your response confidential, please clearly mark this on your response and explain why.

1.19. If you wish us to keep part of your response confidential, please clearly mark those parts of your response that you *do* wish to be kept confidential and those that you *do not* wish to be kept confidential. Please put the confidential material in a separate appendix to your response. If necessary, we'll get in touch with you to discuss which parts of the information in your response should be kept confidential, and which can be published. We might ask for reasons why.

1.20. If the information you give in your response contains personal data under the General Data Protection Regulation (Regulation (EU) 2016/679) as retained in domestic law following the UK's withdrawal from the European Union ("UK GDPR"), the Gas and Electricity Markets Authority will be the data controller for the purposes of GDPR. Ofgem uses the information in responses in performing its statutory functions and in accordance with section 105 of the Utilities Act 2000. Please refer to our Privacy Notice on consultations, see Appendix 4.

1.21. If you wish to respond confidentially, we'll keep your response itself confidential, but we will publish the number (but not the names) of confidential responses we receive. We

won't link responses to respondents if we publish a summary of responses, and we will evaluate each response on its own merits without undermining your right to confidentiality.

General feedback

1.22. We believe that consultation is at the heart of good policy development. We welcome any comments about how we've run this consultation. We'd also like to get your answers to these questions:

1. Do you have any comments about the overall process of this consultation?
2. Do you have any comments about its tone and content?
3. Was it easy to read and understand? Or could it have been better written?
4. Were its conclusions balanced?
5. Did it make reasoned recommendations for improvement?
6. Any further comments?


Please send any general feedback comments to stakeholders@ofgem.gov.uk

How to track the progress of the consultation

You can track the progress of a consultation from upcoming to decision status using the 'notify me' function on a consultation page when published on our website.

[Ofgem.gov.uk/consultations.](https://www.ofgem.gov.uk/consultations)


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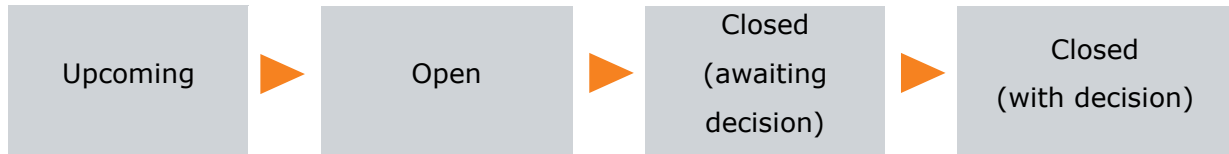
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2. Proposed Cost Allowances for the Shetland Link Project

Section summary

This section details our views on each of the main cost areas in SSEN Transmission’s Project Assessment funding request, including where we are minded to make adjustments.

Questions

Question 1: Do you agree with our proposed cost allowances for the Shetland Link project?

Question 2: Do you agree with our proposals on how to treat the following types of risk: high impact, low probability; difficult to quantify; and Covid risks?

2.1. SSEN Transmission’s submitted costs for the Shetland Link project were broken down into the following cost categories: Project Management, Regulation and Consent, Engineering, Construction, Commissioning, Operations, Insurance, Other and Risk.

2.2. Our project assessment approach combined qualitative assessment (of the project assessment narrative document, various supporting documents, and responses to supplementary questions) with quantitative assessment (of cost data submissions, including cost benchmarking against specific comparable project areas in our internal database). These were supplemented with nuanced information from weekly engagement with SSEN Transmission in meetings and workshops on various project aspects and cost areas.

2.3. The table below summarises our proposed adjustments to SSEN Transmission’s submitted cost allowances for the project. Our treatment of each cost category is as set out in this section, together with our proposed adjustments and reasons for each.

Summary of our proposed cost allowances for the Shetland Link project

Cost Category	Submitted Cost (£m)	Proposed Adjustment (£m)	Proposed Allowance (£m)
Project Management	45.4	0.0	45.4
Regulation and Consent	8.3	-0.6	7.7
Engineering	6.3	-0.3	6.0
Construction	519.4	-15.0	504.4
Commissioning	3.2	0.0	3.2
Operations	13.4	0.0	13.4
Insurance	1.0	0.0	1.0
Non-LOTI	-6.3	0.0	-6.3
Other	16.2	-0.5	15.7
Risk	68.6	-30.3	38.3
Total	675.4⁹	-46.8	628.6

Project Management, Commissioning, Operations, Insurance, Non-LOTI and Other

2.4. We are proposing to allow all submitted costs in these cost categories because our assessment indicates that they are economic and efficient.

2.5. We have assessed and propose to allow the project management costs in full in consideration of SSEN Transmission’s multi-contract delivery strategy for this project. In this instance and for this project we are comfortable that SSEN Transmission’s chosen strategy results in higher project management costs, but lower project costs overall compared to an Engineering, Procurement, and Construction (EPC) delivery strategy.

2.6. We have also taken into account SSEN Transmission’s project management cost in our assessment of the risks to the project. Our views and minded-to position on risk are set out in full at paras 2.17-2.29 below. In summary, we consider that SSEN Transmission is appropriately funded, through the proposed project management allowance, to manage risks associated with interfaces between its different contractors. This will allow it to significantly reduce the likelihood of these risks occurring and their impacts if they occur.

⁹ Totals may not sum up due to rounding.

2.7. SSEN Transmission submitted £6.3m of costs relating to the Non-LOTI category as a net deduction to remove costs associated with the VEWf from the Shetland Link costs. These are costs that SSEN Transmission negotiated jointly with its contractors for delivery of both VEWf and the Shetland Link project. The VEWf costs are separate, however, and not part of the Shetland Link costs.

Regulation and Consent

2.8. We are proposing not to allow £0.6m of submitted costs from this category. These are costs that SSEN Transmission paid due to delays in the use of the access track at Upper Kergord, Shetland. As a result of these delays, SSEN Transmission purchased additional land to provide alternative site access. We propose not to allow these costs because SSEN Transmission should seek to recover these costs from VEWf, who caused the delay.

Engineering

2.9. We are proposing not to allow £0.3m of submitted costs from this category. SSEN Transmission notified us of a £0.3m reduction in business information modelling support (BIMS) costs due to an amended scope of works. This resulted in a cost-saving of £0.3m that we propose to remove from the cost allowance.

Construction

2.10. We are proposing not to allow £1.1m of submitted incentivisation costs from this category. These are costs that SSEN Transmission proposes to pay its contractors to speed up works schedules in case of delays. We consider that these costs are neither economic nor efficient. SSEN Transmission is responsible for managing its contractors and related schedules and we have received no evidence to show that consumers would benefit from early delivery of these pieces of work. We therefore do not consider that it represents value for money for consumers to pay extra for this.

2.11. We are minded not to allow £0.9m of submitted costs relating to the provision of hot meals on site in Shetland. This reflects an adjustment of the unit cost of each meal to reflect our benchmark figure. We are also minded not to allow £0.6m of submitted DNO connection costs at Noss Head and Kergord. This is to reflect a contract cost saving negotiated by SSEN Transmission and the removal of VAT costs that were incorrectly included by SSEN Transmission in its submission. These DNO connection costs were not competitively tendered but SSEN Transmission has demonstrated that it achieved savings above the market benchmark value.

2.12. SSEN Transmission submitted costs for the land cable and sea cable for this project. While the land cable costs were above what would be expected on an 'average' project of this type, the sea cable costs were less than what we would expect. SSEN Transmission's reasoning for this was that both of these items were procured together and as such, some costs can be shared. We propose to allow the land cable costs and sea cable costs.

Converter Station Technology and Civils

2.13. SSEN Transmission submitted costs for the converter station at Upper Kergord, Shetland. This is a mixture of single source and competitively tendered contracts. We have undertaken a bottom-up analysis of this figure, which has considered a range of project-specific circumstances that have led to an increased cost in comparison to an 'average' project.

2.14. There are several project-specific factors that we've taken into careful consideration. The Shetland Link is part of a DC Grid and involves the use of multiterminal HVDC technology to join with the Caithness-Moray Link. It is the first deployment of this technology outside of China and was approved by Ofgem in the Caithness-Moray Link needs case assessment ¹⁰. SSEN Transmission has stated that it was necessary to single-source the HVDC technology element due to its uniqueness and the need to interface correctly with Caithness-Moray.

2.15. In addition, we have accepted ground conditions, site duration, abnormal design, engineering, project management and commissioning as sources of project-specific cost. We have not accepted extra over environmental mitigation, temporary platform and compound and site enabling and access works as we are not satisfied that these extra amounts are justified in excess of what has already been accepted as project-specific factors.

2.16. The result is that we are comfortable that robust evidence has been provided to justify a reduced cost allowance - still significantly above our benchmark value for an average converter station on a project of this type. This results in a figure of £12.4m that we do not consider sufficient evidence has been provided to justify, even taking into account a separate

¹⁰ Caithness-Moray Decision on Final Needs Case: <https://www.ofgem.gov.uk/publications/decision-needs-case-assessment-proposed-caithness-moray-electricity-transmission-project-under-strategic-wider-works>

benchmarking report provided by SSEN Transmission. We propose to remove this figure from the cost allowance.

Risk

2.17. Within its original Project Assessment submission, SSEN Transmission included £51m relating to project risks during construction. In May and August 2021, it provided a request for additional costs of £17.6m relating to Covid and Brexit, bringing its total risk costs submission to £68.6m. We are minded to allow reduced up-front cost allowances for risk of £38.3m (a reduction of £30.3m on the total figure requested). This cost covers only the risk managed directly by SSEN Transmission; we have dealt with separately and are minded to allow additional risk that has been transferred to contractors. This section includes further detail of how our minded-to position on risk is split across risk categories and our proposed treatment of high impact, low probability risk.

2.18. The proposed up-front cost allowance of £38.3m (5.7% of the project costs) represents SSEN Transmission-only risk. There is another 6.6% of project risk that SSEN Transmission has transferred to its contractors that we are minded to allow. This brings the total proposed project risk percentage to 12.3% of the project costs. We consider that this is a reasonable level of risk coverage given the unique characteristics of the Shetland Link, complexity involved in constructing in the Northern Isles of Scotland and SSEN Transmission's multi-contract delivery strategy.

General Project Risk

2.19. This represents the initial £51m of risk submitted via the project risk register. We have undertaken a qualitative bottom-up assessment of SSEN Transmission's risk register and excluded risks that we consider are ineligible for consumer funding. These can be broadly grouped into the following:

- risks relating to interfaces between SSEN Transmission's contractors,
- risks which we consider have sufficient coverage within minded-to allow costs,
- risks that should be borne by parties other than the consumer, such as contractors,
- and risks that no longer apply, such as those relating to an event which has passed.

2.20. If these risks materialised, SSEN Transmission would need to recover these from other parties (e.g., contractors) or use its general risk allowance to cover the costs, and any overspend would be treated through the RIIO totex sharing factor (i.e., split between SSEN Transmission and consumers).

Covid and Brexit Risk

2.21. In a follow up to its project submission in November 2020, SSEN Transmission submitted additional costs of £17.6m in May and August 2021 for risks relating to the impact of the coronavirus pandemic ("Covid", £14.3m) and the UK's exit from the European Union ("Brexit", £3.3m).

2.22. In its submission, SSEN Transmission proposed that we consider risks relating to Covid and Brexit under the COAE mechanism but without a threshold trigger for SSEN Transmission to apply to Ofgem for additional funding. We have considered SSEN Transmission's proposal and assessed the costs and provided our views below.

2.23. Brexit: We have assessed these costs in full as part of the upfront risk cost allowances rather than as part of COAE because we consider the timeline between the Brexit trade deal and the risks occurring allows SSEN Transmission to effectively predict and mitigate them. We are proposing to allow £1.4m of future costs that have been reasonably justified in up front allowances. We are minded not to allow £1.9m of unjustified Brexit risk costs submitted.

2.24. Covid: We are proposing to allow £3.8m of appropriately justified incurred and future costs to be included in up front allowances and not to allow £0.1m of unjustified submitted costs. However, a further £10.4m of future costs are highly uncertain due to the evolving situation around Covid and we do not consider that it is appropriate to estimate these in up-front cost allowances as this would create a risk for consumers or SSEN Transmission. Therefore, we are proposing that SSEN Transmission can recover justified and efficiently incurred future Covid costs through a new, no-threshold, part of the COAE that is ringfenced for Covid costs. We have provided additional information on this in paragraph 2.29 of this document.

2.25. As the risk register is a live document, we will complete a further review in advance of our decision as the uncertainty on risk reduces with the progress of construction activities on the project.

High impact, low probability (HILP) and difficult to quantify risks

2.26. We consider that risks which are highly unlikely to occur, but that would have a high cost impact if they did, and certain risks that are difficult to quantify up-front, should not be included in the up-front cost allowances we set at Project Assessment. We consider that if these risks occur, they should be considered for funding through a specific and targeted cost reopener mechanism. This approach serves two purposes:

- It prevents consumers unnecessarily paying for risks which are highly unlikely to occur or are difficult to robustly quantify before they occur.
- It provides SSEN Transmission with comfort that if a high cost risk occurs, that is beyond its control and that has a material impact on overall project cost, it would be funded for the efficient costs that it incurs relating to that risk.

2.27. SSEN Transmission's licence already includes a Cost and Output Adjusting Event (COAE) provision within the LOTI re-opener condition that allows it to recover costs associated with some HILP risks for a LOTI re-opener project. We are proposing the following modifications to this existing COAE provision in order to implement the approach proposed above for the Shetland Link:

- In addition to risks which the COAE provision already covers, such as extreme weather, the modified COAE provision would include other specific 'qualifying' risks we have identified for the Shetland Link that it would be inefficient to set allowances for now. The full list is included in Appendix 2, Table 1.
- We propose to modify the provision to reduce the COAE threshold for the Shetland Link from 20% of total project capex provided for in the licence, to 10%. This is because some of the risks we are proposing to include within the scope of the modified COAE may be of a lower value than was envisaged when the COAE provision was drafted. This approach is consistent with the 10% COAE threshold we set on NGET's Hinkley Seabank project and NGET/SPT's Western HVDC project and is consistent in overall capital cost terms with SSEN Transmission's Caithness-Moray project, where we set a 5% COAE threshold for a c.£1bn project.

2.28. The effect of these changes would be that if one or more relevant qualifying risks occurred during the construction period for the Shetland Link, and the total cumulative cost

impact was 10% or above total project cost allowance, SSEN Transmission would receive full funding for its efficient costs in relation to addressing those risks.

2.29. We also propose to modify the COAE provision for the Shetland Link to include a ringfenced no-threshold section for Covid costs as we recognise that additional, but highly uncertain, project costs may be incurred due to the ongoing Covid pandemic. Any such costs would be reviewed to ensure that they are economic and efficient.

Interaction with Opex Escalator mechanism

2.30. In our RIIO-2 framework, we introduced the Opex Escalator mechanism, a method by which the closely associated indirect (CAI) costs and network operating costs (NOCs) of a project are automatically calculated based on the project's efficient direct capex. We decided in our Final Determinations for the electricity transmission sector that this mechanism will apply to LOTI projects.

2.31. During our cost assessment of the Shetland Link, we have assessed in more detail the practical implementation and applicability of this mechanism to LOTI projects. We have also examined the likely impact of this mechanism on LOTI projects in general and the Shetland Link project in particular.

2.32. Our view is that the bespoke nature of LOTI projects makes them unsuited to a mechanistic uplift of both CAI costs and NOCs and we now intend to move the funding for these costs from the Opex Escalator mechanism to the LOTI mechanism. Our approach to the project assessment of the Shetland Link reflects this intention, i.e., the scope of the project assessment includes CAI costs and NOCs and these costs will be funded via the LOTI re-opener rather than the Opex Escalator mechanism. We are consulting separately on our proposal to change the Opex Escalator mechanism¹¹. We will make our decision on the Shetland Link project assessment after the decision on the proposed changes to Opex Escalator mechanism has been made.

¹¹ Notice of Statutory Consultation to Modify Special Condition 3.36 Opex Escalator for Electricity Transmission, August 2021
<https://www.ofgem.gov.uk/publications/notice-statutory-consultation-modify-special-condition-336-opex-escalator-electricity-transmission>

3. Proposed Output and Delivery Date for the Shetland Link Project

Section summary

This section details our views on the output and delivery date of the Shetland Link project and our proposed consequent implementation of the Large Project Delivery mechanisms.

Questions

Question 3: Do you agree with our proposed output and delivery date for this project?

Question 4: Do you agree with our view on the implementation of the Re-Profiling and Project Delay Charge Large Project Delivery (LPD) mechanisms on this project? In particular, do you have a view on the application and level of the Project Delay Charge?

Outputs and Delivery date

3.1. We propose “Shetland HVDC link” as the output for the Shetland Link project. We propose that this output will include the timely delivery of the following components of the project:

- A new 132kV AC Gas Insulated (GIS) substation at Upper Kergord, Shetland;
- A new convertor station at Upper Kergord, Shetland;
- A 261km +/-320kV 600MW HVDC single circuit cable between Upper Kergord, Shetland and Noss Head, Caithness; and
- A new HVDC switching station at Noss Head, Caithness.

3.2. SSEN Transmission has advised us that it will not be able to demonstrate the full 600MW capacity of the HVDC cable at project completion due to insufficient generation capacity and/or demand up to that level on Shetland. It has proposed to demonstrate the delivery of this component by completing lower power transfer tests in export and import modes. These tests will be supported by design and modelling documentation to demonstrate that the link is capable of 600MW power transfers. SSEN Transmission has stated that

subsequent tests at incremental capacity levels, eventually up to 600MW, will be undertaken as more generation is installed.

3.3. Subject to the limitations identified in paragraph 3.2, we propose that delivery of the Shetland Link, for the purposes of satisfying the LOTI delivery date, will be taken at the point the link is made fully and freely available to the Electricity Transmission System Operator.

3.4. SSEN Transmission has proposed a scheduled delivery date for the Shetland Link's output as quarter 4 of 2024. We are minded to set the delivery date for the output as 31 December 2024, the last date of the period proposed by SSEN Transmission. This will provide a firm and specific date at which delivery can be assessed.

3.5. This output and delivery date will feed into our proposed implementation of the large project delivery mechanisms discussed in the section below for the Shetland Link.

Large Project Delivery (LPD) mechanisms

3.6. We introduced the LPD framework through our RIIO-2 Final Determinations to incentivise timely delivery and minimise the detriment of late project delivery on consumers. The framework consists of the Re-profiling, Milestone-Based Approach and Project Delay Charge mechanisms. Additional information on the LPD framework is provided in the LOTI re-opener guidance.

3.7. We propose to apply re-profiling of allowances to the Shetland Link in line with our final determinations which said that we would re-profile the allowances of any project which is delivered late to match the actual expenditure profile, unless the Milestone-Based Approach is used. Re-profiling would remove any financial benefit to SSEN Transmission from delayed project delivery.

3.8. We do not propose to apply the Milestone-Based Approach to the Shetland Link because we do not consider that there are any appropriate milestones in the delivery plan. As such we propose to apply re-profiling of allowances.

3.9. We have also considered whether to apply a Project Delay Charge, should the Shetland Link be delayed beyond the proposed delivery date. We do not consider that delay of a major project such as the Shetland Link should be without consequences. However, we note that any delay to the Shetland Link would not be likely to lead to material detriment to consumers, unless the period of delay was substantial and resulted in a delay to the connection of the

VEWF project and/or resulted in an extension to the life of Lerwick Power Station, which currently helps provide security of supply to the Shetland Isles¹². A delay to the connection of the VEFW project could have a negative environmental impact, as non-renewable generation may be required to operate in its place. Extending the life of Lerwick Power Station would also have a negative environmental impact, and would likely lead to costs to GB consumers, depending on the length of the delay.

3.10. We consider that there are two possible Project Delay Charge options for the Shetland Link and welcome stakeholder feedback to inform our decision on which option to apply.

3.10.1. Under the first option, we could apply a modest ex-ante Project Delay Charge in the region of £30k-£121k for each day that the link is delivered late. This range has been calculated through qualitative consideration of information provided by SSEN Transmission regarding its Liquidated Damages arrangements underpinning contracts for delivery of the Shetland Link, which in total exceed £900k per day of delay. We consider that this could provide a reasonable financial incentive on SSEN Transmission to deliver on time and would set out clear consequences of delay.

3.10.2. Under the second option, we could decide not to apply a pre-determined delay charge, and instead investigate the ex-post retrieval of appropriate Liquidated Damages.

3.11. Under both options we may also consider the impact and consequences of delay as part of any enforcement case where there is late delivery of the Shetland Link.

¹² As set out earlier, security of supply on Shetland is currently primary provided by the Lerwick Power Station, which is due to close in 2025.

4. Proposed Licence Modifications for Delivery of the Shetland Link Project

Section summary

This section details the proposed licence modifications we consider necessary to support delivery of the Shetland Link project in line with the proposals set out in the earlier sections of this document, including our reasons for the proposed modifications and their effect. Notice of the proposed modifications is provided at Appendix 2.

Questions

Question 5: Do you agree with our proposed modifications to Special Condition 1.1 of SSEN Transmission's licence?

Question 6: Do you agree with our proposed modifications to Special Condition 3.31 of SSEN Transmission's licence?

4.1. We are proposing to make all of the modifications required to give effect to the project as statutory modifications under section 11A of the Act. Notice of and the full text of the proposed modifications are provided in Appendix 2 of this document.

Proposed modifications to Special Conditions 1.1 and 3.13 of SSEN Transmission's licence

4.2. The delivery of the Shetland Link will expand SSEN Transmission's current transmission area beyond the current definition stipulated in its licence. As such, we are proposing to modify Special Condition 1.1 of SSEN Transmission's licence to reflect this change by (i) inserting the 'Shetland HVDC Link' as new defined term; and (ii) amending the definition of SSEN Transmission's transmission area to include the Shetland Link. The reason for the proposed modification is that, as currently defined, the Shetland Link would sit outside of SSEN Transmission's transmission area. The result of the proposed changes is that the transmission area in SSEN Transmission's licence will be extended to include the Shetland Link.

4.3. We are proposing to modify special condition 3.13 to include delivery of the Shetland Link project. The reason for the proposed modification is that, currently, the Shetland Link is not specified as an output for SSEN Transmission in this current price control. The change is

necessary to ensure that SSEN Transmission has clear outputs for the delivery of this project in its licence. The result of the proposed modifications will be that the Shetland Link is a clear deliverable within SSEN Transmission's licence and in this price control. In accordance with the licence, following this consultation, we will specify the outputs, delivery date and allowances for the Shetland Link shown at Appendix 2 of Special Condition 3.13.

4.4. We are also proposing to make modifications to the existing COAE provisions in Special Condition 3.13 of SSEN Transmission's licence. The reasons and effects for the modifications to the existing COAE provisions of Special Condition 3.13 are provided in paragraphs 2.276 to 2.28 of Chapter 2 of this document.

5. Next Steps

5.1. We welcome your responses to this consultation, both generally, and in particular on the specific questions in Chapters 2, 3 and 4. Please send your response to:

riioelectricitytransmission@ofgem.gov.uk. The deadline for responses is 04 October 2021.

5.2. Having considered responses to this consultation, we will publish our decision on the project assessment of the Shetland HVDC Link project. We will not publish that decision until we have published our decision on the proposal to exclude LOTI re-opener projects from the Opex Escalator mechanism. We will endeavour to publish both decisions by the end of November 2021.

5.3. As part of publication of our decision, we will also publish our decision on the proposed modifications to Special Conditions 1.1 and 3.13 of SEN Transmission's licence.

Appendices

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Appendix 1 – Consultation Questions

Chapter 2: Proposed cost allowance for the Shetland Link project

Question 1: Do you agree with our proposed cost allowances for the Shetland Link project?

Question 2: Do you agree with our proposals on how to treat the following types of risk: high impact, low probability; difficult to quantify; and Covid risks?

Chapter 3: Proposed Output and Delivery Date for the Shetland Link project

Question 3: Do you agree with our proposed output and delivery date for this project?

Question 4: Do you agree with our view on the implementation of the Re-Profiling and Project Delay Charge Large Project Delivery (LPD) mechanisms on this project? In particular, do you have a view on the application and level of the Project Delay Charge?

Chapter 4: Proposed Licence Modifications for the delivery of the Shetland Link project

Question 5: Do you agree with our proposed modifications to Special Condition 1.1 of SSEN Transmission's licence?

Question 6: Do you agree with our proposed modifications to Special Condition 3.31 of SSEN Transmission's licence?

Appendix 2 – Notice of Statutory Consultation on Proposed Licence Modifications

To:

Scottish Hydro Electric Transmission Plc

Electricity Act 1989

Section 11A (2)

Notice of statutory consultation on a proposal to modify the Special Conditions of the electricity transmission licence held by the above licensee

1. The Gas and Electricity Markets Authority ('the Authority')¹³ proposes to modify the electricity transmission licence held by the above licensee ("the licensee"), granted or treated as granted under 6(1)(b) of the Electricity Act 1989 by amending existing Special Conditions: Special Condition 1.1 Interpretation and definitions and Special Condition 3.13 Large onshore transmission investment Re-opener (LOTIAI and LOTIREt).
2. Further detail on the reasons and effects of the proposed modifications can be found in paragraphs 2.26 to 2.29 of chapter 2 for proposed modifications to Special Condition 3.13 (COAE) and paragraphs 4.1 to 4.5 of chapter 4 for proposed modifications to Special Condition 1.1 (transmission area) and Special Condition 3.13 (outputs). Alternatively they are available from foi@ofgem.gov.uk. The full text of the proposed modifications to Special Condition 1.1 Interpretation and definitions and Special Condition 3.13 Large onshore transmission investment re-opener are set out below.
3. Any representations with respect to the proposed licence modifications must be made on or before 04 October 2021 to: James Norman, Office of Gas and Electricity Markets, 10 South Colonnade, Canary Wharf, London, E14 4PU or by email to riioelectricitytransmission@ofgem.gov.uk.
4. We normally publish all responses on our website. However, if you do not wish your response to be made public then please clearly mark it as not for publication. We prefer to receive responses in an electronic form so they can be placed easily on our website.
5. If we decide to make the proposed modifications, they will take effect not less than 56 days after the decision is published.

¹³ The terms "the Authority", "we" and "us" are used interchangeably in this document.

.....

James Norman

Head of Electricity Transmission Development

Duly authorised on behalf of the

Gas and Electricity Markets Authority

03/09/2021

Proposed modifications to Special Condition 1.1 of SSEN Transmission’s licence

1.2. As referred to in paragraph **Error! Reference source not found.** of the main document, we are proposing to make two modifications to Special Condition 1.1 of SSEN Transmissions licence. These modifications are detailed below.

(i) - The insertion of a new defined term “Shetland HVDC Link”

1.3. We are proposing to insert a new term defined term “Shetland HVDC Link”, the full text of which is set out below. The new term will be inserted immediately after the definition of “Shared Services”.

Shetland HVDC Link	<p>means the high voltage electric lines and electrical plant which:</p> <p>(a) comprise the following components:</p> <p>(i) a 600MW HVDC cable system, the sole purpose of which is to transmit electricity between a converter station at Upper Kergord on Shetland and an HVDC switching station at Noss Head near Wick on the Scottish mainland, both within the area specified in the Electricity Act 1989 (Uniform Prices in the North of Scotland) Order 2005, via a single circuit onshore and subsea cable corridor route contained within:</p> <p style="padding-left: 40px;">(A) the territorial sea adjacent to the United Kingdom as defined in The Territorial Waters Order in Council 1964, The Territorial Sea Act 1987, the Territorial Sea (Baselines) Order 2014 or The Territorial Sea (Amendment) order 1998 or as defined in the United Nations Convention on the Law of the Sea Part II Section II Articles 3-5;</p> <p style="padding-left: 40px;">(B) any Renewable Energy Zone; and</p> <p style="padding-left: 40px;">(C) the continental shelf as designated under section 1(7) of the Continental Shelf Act 1964 or The Continental Shelf (Designation of Areas) Order 2013, or as defined in the United Nations Convention on the Law of the Sea Part VI Article 76;</p> <p>(ii) those converter and switching stations at each end of the HVDC cable system described in sub-paragraph (i) to facilitate the conversion of power from alternating current at Upper Kergord, to direct current for export to the mainland national electricity transmission system and to complete a multi-terminal HVDC system with the existing Caithness-Moray HVDC Link via the Noss Head switching station;</p> <p>(iii) cables to connect the HVDC converter station described in sub-paragraph (ii) to an alternating current substation at Upper Kergord on Shetland; and,</p> <p>(iv) cables and tie-in works with the existing Caithness-Moray HVDC Link at Noss Head; and</p>
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(b) does not transmit electricity for the purposes of offshore transmission as defined in the Act.

(ii) – Amendment to the defined term “Transmission Area”

1.3. The existing term is shown below. We are proposing the addition of the text shown in **bold and highlight** below.

Transmission Area means the area specified in the Electricity Act 1989 (Uniform Prices in the North of Scotland) Order 2005 made on 1 April 2005 and the Kintyre-Hunterston Transmission Line up to and including the transition joint lying within the West Kilbride Golf Course to the north of the landing point at Ardnail Bay, the subsea corridor within the territorial sea adjacent to Great Britain or within any Renewable Energy Zone or within an area designated under section 1(7) of the Continental Shelf Act 1964 that any part of the Caithness Moray HVDC Link **and the Shetland HVDC Link** owned by the licensee passes through, but excluding the Cruachan Transmission Line.

Proposed modifications to Special Condition 3.13 of SSEN Transmission’s licence

1.4. As referred to in paragraph 4.3, we are proposing two changes to Special Condition 3.13 of SSEN Transmission’s licence. The proposed changes are shown below in **bold and highlight text**.

(i) - The amendment of part G of Special Condition 3.13.

3.13.14 The licensee may only apply to the Authority for a direction adjusting the LOTI Output, the delivery date or associated allowances in Appendix2 where:

(a) there has been one or more Cost And Output Adjusting Events; and

(b) if the following requirements are met:

i. the licensee could not have reasonably foreseen the event or events;

ii. the licensee could not have economically and efficiently planned a contingency for the event or events;

iii. expenditure has been caused to increase or decrease by at least the percentage specified in, or in accordance with, paragraph 3.13.15,

calculated before the application of the Totex Incentive Strength Rate, relative to the relevant allowance in Appendix 2 by the event, or, if there has been more than one event;

- by each event; or

- by any one or more events that the Authority has directed may count cumulatively towards the percentage threshold; and

iv. the increase or decrease in expenditure is expected to be efficiently incurred or saved.

v. in the case of the Shetland link, a pre-defined cost and output adjusting event as detailed in the table below

Risk	Definition	Proposed Treatment
Covid	Additional project costs incurred that are directly attributable to the ongoing Covid pandemic and not covered by any insurances or contractual arrangements.	Ringfenced no-threshold assessment of incurred costs
Physical damage to Flotta oil pipeline	Contractor damage to pipeline occurs during construction. Delays to programme schedule, environmental impact and damage to 3rd party asset.	10% COAE threshold
Multi-terminal HVDC deployment	Additional project costs incurred that are directly attributable to deploying the multi-terminal HVDC technology and not covered by any insurances or contractual arrangements.	10% COAE threshold
Extreme weather	Additional costs directly attributable to extent of extreme weather above 1-in-10 year value.	10% COAE threshold

3.13.15 *The percentage referred to in paragraph 3.13.14 is:*

(a) 20%; or

(b) such other percentage as the Authority may specify by direction; or

(c) 10% in the case of the Shetland link project; or

(d) no threshold in the case of covid costs as defined above for the Shetland link project.

3.13.16 *Unless the Authority otherwise directs, the licensee must make any application no later than before the end of the period of three months beginning with the delivery date for the LOTI Outputs.*

3.13.17 *An application under paragraph 3.13.14 must be made in writing and must:*

(a) include detailed supporting evidence that a Cost And Output Adjusting Event meeting the requirements set out in paragraph 3.13.14 has occurred;

(b) set out any amendments requested to the LOTI Output, the delivery date or associated allowances in Appendix 2;

(c) explain the basis of the calculation for any proposed adjustment to the allowances in Appendix 2, which must be designed to keep, so far as is reasonably practicable, the financial position and performance of the licensee the same as if the Cost And Output Adjusting Event had not occurred; and

(d) include a statement from a technical adviser, who is external to and independent from the licensee, whether, considered in the context of the value of the LOTI Output, the proposed adjustments to the LOTI Output, the delivery date or associated allowances fairly reflect the effects of the Cost And Output Adjusting Event. specify by direction.

(ii) – The insertion of a new column, outputs, delivery date and allowances to appendix 2

As referred to in paragraph 4.4, we are proposing the modification of Special Condition 3.13 of SSEN Transmissions licence. The proposed changes are shown below in **bold and highlight text**.

Appendix 2

LOTI Outputs, delivery dates and allowances (£m)

	Regulatory Year						
LOTI Output	Delivery date	2020/21¹⁴	2021/22	2022/23	2023/24	2024/25	2025/26
Construct, energise (and subject to restrictions¹⁵) make freely and fully available to the ESO the Shetland HVDC Link	31-Dec-24	111.2	207.0	173.1	106.9	24.6	5.8

¹⁴ For the purposes of the LAR and LRAV inputs to the RIIO-ET2 PCFM, the 2020/21 totex allowance will be adjusted by +£111.2m in the RIIO-ET1 Legacy PCFM.

¹⁵ Insufficient demand/supply capacity on Shetland up to the 600MW level on delivery date.

Appendix 3 – Privacy Notice on Consultations

Personal data

The following explains your rights and gives you the information you are entitled to under the General Data Protection Regulation (GDPR).

Note that this section only refers to your personal data (your name address and anything that could be used to identify you personally) not the content of your response to the consultation.

1. The identity of the controller and contact details of our Data Protection Officer

The Gas and Electricity Markets Authority is the controller, (for ease of reference, "Ofgem"). The Data Protection Officer can be contacted at dpo@ofgem.gov.uk

2. Why we are collecting your personal data

Your personal data is being collected as an essential part of the consultation process, so that we can contact you regarding your response and for statistical purposes. We may also use it to contact you about related matters.

3. Our legal basis for processing your personal data

As a public authority, the GDPR makes provision for Ofgem to process personal data as necessary for the effective performance of a task carried out in the public interest. i.e. a consultation.

3. With whom we will be sharing your personal data

(Include here all organisations outside Ofgem who will be given all or some of the data. There is no need to include organisations that will only receive anonymised data. If different organisations see different set of data then make this clear. Be as specific as possible.)

4. For how long we will keep your personal data, or criteria used to determine the retention period.

Your personal data will be held for ***(be as clear as possible but allow room for changes to programmes or policy. It is acceptable to give a relative time e.g. 'six months after the project is closed')***

5. Your rights

The data we are collecting is your personal data, and you have considerable say over what happens to it. You have the right to:

- know how we use your personal data
- access your personal data
- have personal data corrected if it is inaccurate or incomplete
- ask us to delete personal data when we no longer need it
- ask us to restrict how we process your data
- get your data from us and re-use it across other services
- object to certain ways we use your data
- be safeguarded against risks where decisions based on your data are taken entirely automatically
- tell us if we can share your information with 3rd parties
- tell us your preferred frequency, content and format of our communications with you
- to lodge a complaint with the independent Information Commissioner (ICO) if you think we are not handling your data fairly or in accordance with the law. You can contact the ICO at <https://ico.org.uk/>, or telephone 0303 123 1113.

6. Your personal data will not be sent overseas (Note that this cannot be claimed if using Survey Monkey for the consultation as their servers are in the US. In that case use “the Data you provide directly will be stored by Survey Monkey on their servers in the United States. We have taken all necessary precautions to ensure that your rights in term of data protection will not be compromised by this”.

7. Your personal data will not be used for any automated decision making.

8. Your personal data will be stored in a secure government IT system. (If using a third party system such as Survey Monkey to gather the data, you will need to state clearly at which point the data will be moved from there to our internal systems.)

9. More information For more information on how Ofgem processes your data, click on the link to our “[Ofgem privacy promise](#)”.