

Office of Gas and Electricity Markets
10 South Colonnade
Canary Wharf
London
E14 4PU

27 September 2021

Dear Mark,

SSEN Transmission response to Ofgem's statutory consultation on a proposal to modify the Special Conditions of the Electricity Transmission Licence.

This response is prepared on behalf of Scottish Hydro Electric Transmission Plc (SSEN Transmission), part of the SSE Group, responsible for the electricity transmission network in the north of Scotland.

It is important to note the original purpose of the Opex Escalator (OE). It is intended to provide licensees with automatic allowance adjustments for operational costs (closely associated indirects and network operating costs) associated with the capital expenditure required through our RIIO-T2 uncertainty mechanism projects. This was intended to provide both regulatory certainty and proportionate regulation. We therefore support the continued application of the OE for the other uncertainty mechanisms¹ in our licence and support its removal from Large Onshore Transmission Investment (LOTI) projects only.

We broadly agree with Ofgem that our RIIO-T2 baseline allowance did not include large atypical capex projects and therefore the OE does not capture the atypical indirect costs required to deliver these projects. This is particularly true for SSEN Transmission given we operate across a challenging geography and encounter unique regional factors in the north of Scotland as well as project-specific factors that impact the cost of operating and developing the network.

However, as noted below, these atypical indirects are not unique to LOTI projects.

We are therefore generally supportive of Ofgem's pragmatic approach towards removal of LOTI projects only from the OE, but we have identified the following important areas that require further consideration and clarification from Ofgem as part of this consultation:

Opex Escalator Cost Classification

As noted above, the proposal is for the removal of the OE from LOTI projects only and not from other uncertainty mechanisms.

We note the OE for each TO is different, and is based on the efficient capital and operational costs set for each individual TO's baseline allowance for RIIO-T2. These costs are in turn based on each TO's interpretation of the Regulatory Instruction and Guidance (RIGs) and Business Plan Data Table (BDPT) Guidance at the time of submitting

¹ Medium Size Investment Projects (MSIPs), Visual Improvement Scottish Transmission Assets (VISTA), Subsea cables and Volume Driver projects.

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the RIIO-T2 Business Plans when allocating costs as direct or indirect. Ofgem must be cognisant of how each TO has applied the definition of direct v. indirect costs within their RIIO-T2 baseline which in turn has calculated the OE for each individual TO. For example, historic contracting strategies will determine how indirect costs have been captured and will thus inform the OE value. Ofgem must ensure that the assessment of costs is consistent with how each of the TOs has defined and captured direct and indirect elements when assessing operating costs for the other uncertainty mechanisms. It cannot impose a different view of definitions, even if the three TOs have applied different interpretations, as the OE has been set based on each TO's interpretation. This is particularly important for the uncertainty mechanisms which have a less automatic allowance adjustment, such as Medium Sized Investment Projects (MSIP) or VISTA projects.

By way of illustration, failure to do so could result in Ofgem classifying cost categories as indirect based on differing interpretations of definitions such that the adjustment would not be reflected by the OE, as the escalator uplift is based on that cost being classed as direct capex. This would result in a double reduction to allowances as the TO would lose the direct capex allowance, and the associated indirect opex allowance would also be reduced as it is calculation on the basis of the residual direct capex. This would leave the TO with insufficient allowances to cover the cost of economically and efficiently delivering the project. The only alternative would be to recalibrate the OE for each of the TOs which is not proportionate or practical. Ofgem need to be consistent with the approach set out for RIIO-T2 when defining cost categories.

Consistency with definitions adopted at the time of Business Plan Submission will also help provide an element of regulatory certainty on the treatment of costs, during each cost assessment for uncertain projects.

Cost Assessment Process for LOTI

A further point with respect to regulatory certainty concerns Ofgem's proposed approach to assessing indirect costs and operating costs of LOTI projects.

Ofgem set out that a more bespoke assessment of these costs enables them to take a holistic view of how and where costs are allocated within these projects. However, Ofgem does not provide the required detail on how this assessment will be carried out. Ofgem must set out the alternative cost assessment process that will be adopted in place of the OE for LOTI projects.

We would also call for the provision of a cost assessment methodology for LOTI projects more generally and feel that the current process shows a severe lack in due process and due diligence. While it was high level and needed development, there was at least an overarching framework for costs assessment for T2 Business Plans. Given we are forecasting similar levels of expenditure on UMs, particularly LOTI projects during T2, it is a significant process gap not to have a cost assessment methodology for LOTI projects.

Atypical Costs

We agree with Ofgem's view that LOTI projects will contain bespoke and atypical indirect costs due to the nature of the assets required or construction activities. However, we also believe that these bespoke and atypical costs will also exist within a small portion of MSIP which have, for example, subsea cables associated with them. This will be on a lesser scale than LOTI projects, such as Shetland, but the associated indirect costs with this activity will be greater than the uplift provided by the OE. As a result, these atypical indirect costs need to be assessed outside and, in addition to, the OE. This approach will reflect the additional indirect costs associated with installing subsea cable that is not captured within the OE. An example of this is on our Kergord to Yell project which has a section of subsea cable that will require Opex allowances greater than the escalator given the atypical nature of the works.

We believe that the OE is still appropriate for the majority of MSIP projects and this will impact only a few atypical projects.

Shetland

We would also like to note that the Shetland Project is currently in the Project Assessment and this Statutory Consultation should not delay the outcome of the consultation or decision.

Reserving our position

Our response to this statutory consultation highlights several points that require further consideration by Ofgem. While we broadly agree with Ofgem's proposed licence amendment, given this is a fundamental change to a RIIO-T2 policy set out at Final Determinations and within our Special Licence, we must reserve our position on the outcome of this and any future licence changes.

If you have any questions regarding any of the information within this consultation response, please do not hesitate to get in touch.

Yours sincerely

David Manson
Senior Regulation Analyst