

Ofgem  
Commonwealth House  
32 Albion Street  
Glasgow  
G1 1LH  
By Email: [riioed2@ofgem.gov.uk](mailto:riioed2@ofgem.gov.uk)

10 February 2022

Dear Steve,

### **Ofgem RIIO-ED2 Call for Evidence – SSEN Transmission response**

Thank you for the opportunity to respond to this call for evidence on the RIIO-ED2 Business Plans. As the Transmission Operator (TO) for the north of Scotland this response will be largely focused on the particular elements of the plan that relate to the Scottish Hydro Electric Power Distribution (SHEPD) as a direct stakeholder on this network area.

#### **General Comments**

We support the ambitious Business Plan that SSEN Distribution has submitted, particularly given that the baseline plan has been developed to support the pathway to net zero. The energy scenarios on which the plan is based are credible and by including local knowledge, these scenarios continue to build and evolve. We encourage the recognition of the growing regional dynamics.

SHEPD's plans to significantly reduce the number of 'Worst Served Customers' within their rural and island communities in the north of Scotland are welcome. As we move to alternative low-carbon technologies, including our heating and transport, a reliable electricity supply will increasingly become more critical, particularly for remote communities. Therefore, we support targeted investment in asset replacement or refurbishment that addresses the reliability of customer supplies.

#### **Uncertainty Mechanisms – The need for flexibility**

Given the need to decarbonise networks and support the net zero transition across the broader UK economy, it is possible to anticipate the scale of the change, but not always the location or timing. This is because the key drivers of government policy and environmental legislation are out with the control of the network operators. Therefore, we encourage the use of uncertainty mechanisms within the investment programme for RIIO-ED2.

We support SSEN Distribution's view that "there is a need for greater flexibility in the overall package of UMs, which reduces the likelihood of incurring substantial unforeseen and unavoidable costs, or the need to use other less appropriate regulatory mechanisms or ad hoc changes to the licence or regulatory framework". The regulatory framework should not slow or prevent the progress of delivering an energy system for net zero. We encourage Ofgem to view uncertainty mechanisms more holistically and consider the implication on the other energy sectors (RIIO-T2 or GD2).

This makes the flexibility offered by uncertainty mechanism particularly important within the RII0-ED2 price control. We provide more detail on two uncertainty mechanisms that we believe are pertinent to us as a stakeholder of SHEPD.

### *Rail Electrification Reopener*

The electrification of the railway within the North of Scotland is a priority for the Scottish Government over the next 5-10 years which will require significant work across both Transmission and Distribution. While the need is known, the exact scope of works required is not yet known and we are therefore supportive of the rail electrification reopener.

Unlike in England and Wales, where Network Rail will connect directly onto 132kV Distribution network to provide them with the necessary power requirements, in Scotland Network Rail will connect into the 132kV Transmission network. This means a coordinated tripartite approach across Network Rail, SHEPD and SSEN Transmission will be required to deliver the Scottish Government's strategic goal to decarbonise the railways.

Therefore, it is key that the interaction of the regulatory uncertainty mechanism across transmission and distribution allows for the timely investments required to deliver nationally strategic net zero projects.

### *Hebrides and Orkney Whole System (HOWS)*

We are very supportive of the Hebrides and Orkney Whole System (HOWS) uncertainty mechanism. At the time of the Business Plan submission there were a number of Distribution solutions that may result from other areas of the energy sector and highlighted the need for a reopener mechanism. However, the ScotWind announcement and upcoming CfD auction provides more certainty of the need for initial strategic Transmission investment. The HOWS reopener will allow companies to work towards efficient solutions in an environment where the final need and solution will emerge over the coming years.

The HOWS reopener bridges the gap between the Co-ordinated Adjustment Mechanism (CAM) which provides no allowance, and the timing of the Business Plan process as it does not align with external drivers. We acknowledge the success of the Shetland whole system solution delivering significant value to consumers and believe this reopener has the potential to provide similar benefit to consumers through this whole system thinking.

## **Flexibility**

We agree that flexibility has an important role to play within the distribution network for all the reasons set out within SSEN Distribution's Business Plan; (i) flexibility is key to enabling deliverability of the plan and (ii) deferring conventional network reinforcements and commitment to asset-based constructed solutions occurs only when required that efficiently will provide significant savings to consumers. SSEN Distribution's approach to flexibility within the plan delivers value to consumers by using flexibility to economically defer investment and ensures deliverability of the plan.

A general point on flexibility is that given the expected uptake of low carbon technologies, there is a risk that a desire to over utilise or artificially extend flexible solutions rather than reinforce when it is economic and efficient to do so, could create an accumulation of reinforcement projects being required in future price controls. There are several ways and time frames which can be used to quantify benefits of flexibility. In assessing these, there is a need to strike the right balance of flexible solutions and conventional reinforcement.

## **Financial Parameters and Financeability**

We support the concerns highlighted in SSEN Distribution's Business Plan around financeability and the issues the current finance parameters pose on encouraging future investment in the industry. This is particularly pertinent at a time where investment is most critical in order to achieve net zero whilst also ensuring value for consumers and adequate return for shareholders. SSEN Distribution's approach to highlighting their concerns regarding financeability, supported by market evidence and third-party reports, clearly show that there are material errors in the calculation of key credit ratios which significantly impacts the ability to achieve and maintain an investment grade credit rating. We also support the analysis carried out by SSEN Distribution in their business plan regarding gearing, asset lives and capitalisation rates and how these factors should not be manipulated in order to improve credit metrics as these will not solve the underlying issues within the cost of equity calculations.

We believe the importance of strong financial parameters for ED2 is paramount to ensure the industry remains a key market for investors.

## **Challenge Group Report**

Following a review of the Challenge Group report, we have provided our views on the SSEN Distribution section of the report. Overall, we have a differing view to that of the challenge group in relation to the ambitions and level of justification set out within SSEN Distribution's business plan submission.

More specifically, we do not share the view of the Challenge Group that SSEN Distribution's uncertainty mechanisms have "limited ambition or justification". The Challenge Group must have a different interpretation of the purpose of uncertainty mechanisms that protect customers from unnecessarily high baselines, while enabling companies to respond to factors outside of their control. It appears the Challenge Group has given higher scores to companies proposing fewer uncertainty mechanisms compared to those proposing more. There seems to be no consideration of the regional differences or external factors driving the number of uncertainty mechanisms required across the DNOs to meet the needs of their stakeholders.

Our view is that price control flexibility is crucial at this time of considerable uncertainty to ensure that it provides the framework for delivering net-zero.

If you wish to clarify anything in our response, please do not hesitate to contact me.

Yours sincerely

David Manson