Scottish & Southern Electricity Networks
TRANSMISSION

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Via email only: anthony.mungall@ofgem.gov.uk

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Dear Anthony,

Consultation on the closeout methodologies for RIIO-ET1

SSEN Transmission welcomes the opportunity to respond to Ofgem's consultation on the closeout methodologies for RIIO-ET1 published on the 31 January 2021. We are pleased that the areas in scope of the RIIO-T1 closeout are broadly in line with the areas which we have discussed with Ofgem over the last three years. However, we are disappointed that it has taken to the latter end of the first year of the RIIO-T2 price control for Ofgem to develop and consult on the RIIO-T1 price control closeout mechanism. At this stage, the RIIO-T2 Business Plans have been fully assessed by Ofgem, allowances fixed and written into the licence and associated financial models of the T2 price control. This means that any legacy adjustments across the price controls are being dealt with retrospectively, which makes the adjustments more complicated than necessary and any adjustments through the RIIO-T1 close out process may require further amendments to RIIO-T2 allowances in both the licence and associated financial models.

We would urge Ofgem to learn from this experience and ensure that the necessary resource and time is dedicated to the development of close out methodologies ahead of the end T2 price control in 2026. The development of the closeout methodologies should be transparent and developed in collaboration between Ofgem and the TOs. Ideally, we would like to see Ofgem developing the closeout process for future price controls at the same time the relevant licence is developed to ensure that clearly defined methodologies are created which are aligned with the relevant policy intent and this should be the aspiration for RIIO-T3.

We also recommend that Ofgem incorporates the T1 Close Out methodologies into the financial handbook, as outlined within our response to Question 2 below, as this creates a central point for reference to explain legacy adjustments which are included within the RIIO-T2 PCFM.

This letter and our responses in Annex A, set out the key points we would like Ofgem to consider.

Adjustments for crossover projects without volume driver (Advanced Construction Costs)

We agree with Ofgem's proposed approach for T1/T2 crossover projects without volume driver to include the full RIIO-ET1 and RIIO-ET2 allowance within the RIIO-T2 PCD for each crossover project reflecting Ofgem's assessment of total efficient costs for the applicable schemes. However, we believe Ofgem needs to make adjustments to the ET1 Legacy PCFM to account for the associated additional indirects allowance to be based upon the T2 Opex Escalator rate of 10.8% and therefore we believe this needs to be reflected into Ofgem's proposed T1 Close Out methodology.

Adjustments for SHET's VISTA Allowance

Ofgem is proposing to amend RIIO-T1 allowances for late delivery of three VISTA projects which are not due to be delivered until 2022-2024, Sloy, Glen Falloch and Killin. It proposes reducing allowances in RIIO-T1 to the level of costs incurred but with no indication of the corresponding mechanism to adjust allowances up in RIIO-T2 by the same value. This is a flawed application of the previous RIIO-T1 licence and creates an unjustified regulatory administrative burden.

In its proposals, Ofgem acknowledges that the incurred spend against the VISTA schemes is impacted by delays resulting from the COVID-19 pandemic (which are outside our control). It also recognised the potential COVID-19 impact within its RIIO-T1 determination for Sloy and Glen Falloch in July 2020. Costs to deliver these schemes are being incurred within the initial years of the RIIO-T2 price control period and there is no indication that there will be any failure to deliver the required outputs for the total allowances determined. Ofgem also states that only delayed projects in RIIO-T1 will be subject to a downward adjustment in respect of costs incurred in the RIIO-ET1 period and projects scheduled for delivery in RIIO-ET2 are out of scope of RIIO- ET1 closeout.

The RIIO-ET1 licence, paragraph 21 of SpC 6G "Mitigating the impact of Pre-existing Transmission Infrastructure on the visual amenity of Designated Areas", states that Ofgem may revise the EPIE values to "*correct errors in relation to those values, or because the licensee has not Delivered or had only partially Delivered an EPI Output set out in Table 1 of this condition*". Ofgem also states in paragraph 14.4 of the RIIO-T1 Close Out methodology that these projects have experienced a "*failure to deliver during the RIIO-ET1 price control*". We have not failed to deliver any RIIO-T1 outputs as each of the project output delivery dates fall in the RIIO-T2 price control period. Therefore, these three schemes are not in scope under paragraph 6G.21 for Ofgem to downward adjust the RIIO-T1 allowances.

Table 1: VISTA Schemes and Delivery Dates

VISTA Scheme	Delivery Date
Sloy	2022
Glen Falloch	2022
Killin	April 2024

Therefore, we recommend that Ofgem does not adjust the RIIO-T1 allowances for VISTA schemes recognising that the total allowance for each scheme has been provided for between the RIIO-T1 and RIIO-T2 licences.

Furthermore, it is unacceptable for Ofgem to make a downward adjustment to our RIIO-T1 allowances resulting from these COVID-19 delayed projects, without also confirming how and when it will amend the RIIO-T2 allowances upwards by the same value. However, as outlined above, we believe such an adjustment is out of scope of the RIIO-T1 close out process.

<u>Adjustments for Enhanced Physical Site Security Costs</u>

The methodology for Enhanced Physical Site Security Costs is focussed on the ability for Ofgem to recover any allowances received by network companies through the RIIO-T1 reopener windows if the outputs in question were not delivered. However, under "Other Considerations" Ofgem acknowledges that networks may have incurred costs during ET1 that they have not received an allowance for. We welcome this latter point, however we seek clarification from Ofgem that the methodology reflects this intent. Paragraph 10.15 of the consultation document states the requirement for "*each ETO submit a report on any <u>difference between actual costs and outputs for PSUP projects that they have received baseline funding for</u>*", however this does not align with the previous point that network companies may have incurred costs during ET1 that they have not received an allowance for. We would ask Ofgem to clarify that the intent of the methodology under "other considerations" will allow network companies to recover costs incurred where they have not received an allowance for.

<u>Adjustments for asset and related Land Disposals</u>

We do not agree with the proposal to net off disposal proceeds with RAV additions as this does not align with RIIO-1 or RIIO-2 principals. The proceeds from the disposal of assets should be netted-off against Totex from the year in which the proceeds occur. This ensures that TOs are incentivised to achieve the best sale price on any assets no longer required and ensures this benefit is shared with consumers. If the disposal proceeds are netted off against RAV then there is no financial benefit to the TOs to achieve the best sale proceeds when disposing of assets. This is consistent with RIIO-ED1 and RIIO-T2 and this should be aligned in RIIO-T1.

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

Yours sincerely

Sam Torrance
Regulation Manager

Appendix A

Approach to financial modelling methodologies

Question 1: Do you agree with the proposed process in determining any financial revisions for the RIIO-ET1 closeout, including the phasing of the impact?

After reviewing the proposed process in determining any financial revisions for the RIIO-T1 closeout, including the phasing of the impact, we can confirm we agree with the proposed process as long as the agreed approach during the November 2021 AIP process is taken into account. As a result of the delay in implementing some mechanical closeout adjustments, such as sole use exit and entry true up and the associated Excluded Services or DARTS revenue from RIIO-T1, a partial adjustment was processed through the AIP in November 2021. This was agreed with Ofgem during the AIP process in the period September to November 2021.

The adjustment process accounted for two fifths of the adjustment over the period to smooth out the impact on revenue and more closely resemble the spreading of T1 closeout adjustments over the five-year T2 period. If the full adjustment is therefore spread over five years, as two years has already been accounted for in revenue, the last three years of T3 should account for the remaining three fifths of the adjustment. We therefore agree with the proposed process as long as it does not affect the adjustments already accounted for during the November 2021 AIP process.

Question 2: What are your views on what should, or should not, be finally incorporated into the financial handbook?

Regarding what should be incorporated within the financial handbook, Ofgem should be consistent with previous price controls where all closeout methodologies should be fully detailed and included within the handbook.

We suggest that Ofgem should amend the financial handbook to include the closeout methodologies incorporating the following:

- why the proposal has been set out
- how the methodology is calculated including instructions for updating legacy PCFM and how this flows into the RIIO-T2 PCFM and
- the overall outcome of the proposal

By documenting the methodologies in detail within the financial handbook this creates a central point for reference to explain legacy adjustments which are included within the RIIO-T2 PCFM. We would be happy to work with Ofgem to help draft the relevant wording to be included in the financial handbook.

Adjustments to true-up with connection payments

Question 3: Do you agree with our proposed methodology for determining the connection activity adjustment?

We agree with the proposed methodology of a true up to reconcile the difference between the actual income received by each of the ETOs across RIIO-T1 and the assumptions taken when establishing the total allowed revenue to be recovered from annual charges at the start of the price control period. To be clear we would expect the profiles in Step 7 of the proposed methodology are treated as adjustments in the PCFM in row 213 to highlight the actual spend profile not overwriting the total allowance with just the true up adjustment. As per question 1, due to the delay with the implementation of this closeout methodology, a partial adjustment for this was agreed with Ofgem and taken account of in the November 2021 AIP. We therefore agree for the remaining three fifths of this true up to be phased over the last three years of RIIO- T2 in line with our answer to question 1.

Question 4: Do you agree with the proposal to apply a true-up adjustment to both sole use entry connections and sole use exit connections?

We agree with the proposal to apply a "true-up" to match payments received by each of the ETOs across RIIO-T1 and the assumptions taken when establishing the baseline allowance at the start of the price control period to both sole use entry and exit connections. To be clear we would expect the profiles in Step 7 of the proposed methodology are treated as adjustments in the PCFM in row 84 to highlight the actual spend profile not overwriting any total allowances already included in this row with just the true up adjustment. As per question 1 and 3, due to the delay with the implementation of this close out methodology, a partial adjustment for this was agreed with Ofgem and taken account of in the November 2021 AIP. We therefore agree for the remaining three fifths of this true up to be phased over the last three years of RIIO- T2 in line with our answer to question 1.

Based on the calculations for question 3 and 4 we would anticipate our Legacy MOD for 22/23 to be recalculated at circa £65.6m for the full true up adjustment vs £38.8m (two fifths of the true adjustment) which was submitted as part of the November AIP. As highlighted in question 1, we are happy for the delta of these adjustments to be phased across the final three years of RIIO-T2 as long as there are no adverse implications for revenue phasing, volatility or time value of money adjustments (which must also be reflected in any adjustment from T1 to T2).

<u>Adjustments for terminated wider works projects</u>

Question 5: Do you agree with our proposal for assessing TPWW costs?

Not applicable to SSEN Transmission.

Question 6: What revisions may be necessary to the T2 Licence to accommodate the assessment and recovery of all efficiently incurred costs to the point of cancellation through the TPWW mechanism?

Not applicable to SSEN Transmission.

<u>Adjustments for terminated connection projects</u>

Question 7: Do you agree with our proposed methodology for treatment of terminated costs and receipts associated with user terminated generation and demand connections?

Not applicable to SSEN Transmission.

Question 8: What revisions may be necessary to the T2 Licence to accommodate the assessment and recovery of all efficiently incurred costs associated with user terminated generation and demand connections through the TPG/TPD mechanisms?

Not applicable to SSEN Transmission.

Settlement of allowances for pre-construction works

Question 9: What are your views on our proposed methodology to assessing PE outputs?

We agree with the proposed methodology to assessing PE outputs.

SSEN Transmission submitted two output substitution requests in T1, most recently in July 2020. Ofgem confirmed at the time, and through subsequent communications on the close out process, that the level of detail provided to date is in line with the evidence requirements outlined in the consultation. On this basis, our final performance assessment submission will confirm our previously position, but include minor updates as required on forecasted costs.

Adjustments for crossover volume driver projects

Question 11: What are your views on our proposed approach to assessing crossover projects?

Proposed methodology – true up for latest generation connection output delivery expectations of SHET in T1+2

We agree with the proposed application of a true-up to reconcile allowances for the latest view of crossover projects delivering outputs in T1+2 timescale that will be delivered in our final performance assessment submission. We recognise the need to therefore 'net off' any adjustments against any T2 allowances.

Please note: Consultation (paragraph 7.16) states the volume driver allowance calculation '*applies the agreed unit cost rates and an apportionment using a construction profile to phase the funding provision*'. For SSEN Transmission, allowance phasing is based upon an equal 25% split across the four years preceding the connection date.

Common input requirements for proposed T1+2 true up methodologies

With regards to the requirement to provide evidence for all claimed crossover projects, we disagree with the requirement to provide an explanation of financial and cost benefit analysis and any other relevant evidence from the decision-making process. In absence of an applicable T1 CBA template, a new template would need to be provided (or a modified version of the RIIO-2 Business Plan Data Tables CBA template would be used), both of which did not exist in T1 and therefore not used in any decision making during T1. In most cases, our crossover schemes are either completed, or very near completion, so it is inappropriate after the event to expect TOs to provide justifications for crossover schemes in a new format.

Further, this goes against the regulatory principles of the T1 volume driver which was designed as an automatic mechanism based upon pre-agreed metrics deemed to provide: 1) TOs with adequate allowances to recover economic and efficient costs; and 2) consumers value for money. Its mechanistic nature was also designed to alleviate the regulatory burden of Ofgem carrying out need and cost assessments for every volume driver scheme.

Other considerations

Post closeout movements in connection output delivery date: NGET and SHET

We agree with the proposed approach that any movement in the output delivery date within the first two years of RIIO-T2 post closeout decision would be subject to T2 unit rates, but overall allowances will remain the same as agreed at closeout. Therefore changes in the phasing of allowances will be based upon T2 rates, not T1, with corresponding equal and opposite adjustments in allowances across the two years within T1+2 period so allowance neutrality based upon T1 rates is maintained. We also agree that T1+2 volume driver projects agreed at crossover will be added to the capacity baseline against the “BGCp (MW or MVA)” annual profile line in appendix 3 of Special Condition 3.11.

Post closeout movements in connection output delivery volume: NGET and SHET

We agree with the proposed approach in that any incremental movement in crossover scheme output delivery volume post closeout decision (both up and down) will result in allowances as agreed at close out being adjusted to reflect the incremental movement in output based upon T2 volume driver rates.

Question 12: What are your views on our proposed approach to dealing with post closeout changes that occur between finalisation of RIIO-ET1 closeout and 31st March 2023 crossover projects on the following basis:

- **Adjustments for IWW output delivery (NGET only)?**

  Not applicable to SSEN Transmission.

- **T1 volume driver for switching between typical and atypical categories (SHET only)?**

  We agree with the proposed approach that any movements between typical and atypical will be subject a true-up to adjust allowances and volumes.

- **T2 Volume Driver profile adjustments for Physical Output delivery and number of connections (SHET and NGET)?**

  We agree with the proposed approach that any changes to physical outputs during 2021/22 and 2022/23 relating to T2 volume driver schemes would be subject to T2 rate allowances post closeout decision.

<u>Approach for crossover projects without volume driver: NGET</u>

Question 13: Do you agree with our proposed approach?

Not applicable to SSEN Transmission.

<u>Approach for crossover projects without volume driver: SHET</u>

Question 14: Do you agree with our proposed approach?

We agree with the proposed approach to include the full RIIO-T1 and RIIO-T2 allowance within the RIIO-T2 PCD for each crossover project reflecting Ofgem’s assessment of total efficient costs for the four applicable schemes (East Coast 275kV Upgrade, Kinardochy, North east 400kV Upgrade and Tealing 275kV Busbar). Total funding for SSEN Transmission, in line with Ofgem’s PAM modelling, is £46.1m (18/19 prices) for lead/direct costs. In paragraph 9.13 Ofgem notes there would be no change to the ET1 Legacy PCFM, which we agree with in relation to direct costs (i.e. the £46.1m). However, in line with the PCFM handbook, we do believe an adjustment is needed to account for the associated additional indirects allowance to be based upon the T2 opex escalator rate of 10.8%.

<u>Adjustments for Enhanced Physical Site Security Costs</u>

Question 12: Do you agree with our proposed approach to adjusting PSUP allowances at RIIO-ET1 closeout?

As outlined in the covering letter, we would urge Ofgem to allow network companies, who have incurred costs on Enhanced Physical Site Security but have not received any funding for these during RIIO-T1, the opportunity to recover the costs it has incurred from this third party driven work. We believe this was the intent set out in the "Other Considerations" section of the Adjustment for Enhanced Physical Site Security in Ofgem's close out methodology in paragraphs 10.11-10.16. However, the wording of the proposed methodology set out in paragraph 10.15 states for "*each ETO submit a report on <u>any difference between actual costs and outputs for PSUP projects that they have received baseline funding for</u>".* This should be amended to reflect the situation where network companies have not received any allowance for these works as Ofgem acknowledges in paragraph 10.11 and if the network companies can provide the evidence and justification for the costs incurred then it should be able to recover the costs for this third party driven works.

SSEN Transmission has incurred costs for sites identified by BEIS in its PSUP programme, as demonstrated to Ofgem in our 2020/21 RRP submission. We would like the Close Out methodology to be absolutely clear that we have the opportunity to recover these costs.

Can Ofgem clarify that the intent of the methodology under "other considerations" will allow network companies to recover costs incurred where they have not received an allowance for?

<u>Adjustment for SPT's Connection Volume Driver Clawback</u>

Question 15: Do you agree with our proposed methodology?

Not applicable to SSEN Transmission.

<u>Adjustments for asset and related Land Disposals</u>

Question 16: Do you agree with our proposed approach for disposals?

We do not agree with the proposal net off disposal proceeds with RAV additions as this does not align with RIIO-1 or RIIO-2 principals. The proceeds from the disposal of assets should be netted-off against Totex from the year in which the proceeds occur. This ensures that TOs are incentivised to achieve the best sale price on any assets no longer required and ensures this benefit is shared with consumers. If the disposal proceeds are netted off against RAV then there is no financial benefit to the TOs to achieve the best sale proceeds when disposing of assets. This is consistent with RIIO-ED1 and RIIO-T2 and this should be aligned in RIIO-T1.

<u>Adjustments for WHVDC project</u>

Question 17: Do you agree there are no further adjustments required relating to the WHVDC project?

Not applicable to SSEN Transmission.

Adjustments for SHET's VISTA allowance

Question 18: Do you agree with our proposed approach?

Ofgem is proposing to amend RIIO-T1 allowances for late delivery of three VISTA projects which are not due to be delivered until 2022-2024, Sloy, Glen Falloch and Killin. It proposes reducing allowances in RIIO-T1 to the level of costs incurred but with no indication of the corresponding mechanism to adjust allowances up in RIIO-T2 by the same value. This is a flawed application of the previous RIIO-T1 licence and creates an unjustified regulatory administrative burden.

In its proposals, Ofgem acknowledges that the incurred spend against the VISTA schemes is impacted by delays resulting from the COVID-19 pandemic (which are outside our control). It also recognised the potential COVID-19 impact within its RIIO-T1 determination for Sloy and Glen Falloch in July 2020. Costs to deliver these schemes are being incurred within the initial years of the RIIO-T2 price control period and there is no indication that there will be any failure to deliver the required outputs for the total allowances determined. Ofgem also states that only delayed projects in RIIO-T1 will be subject to a downward adjustment in respect of costs incurred in the RIIO-ET1 period and projects scheduled for delivery in RIIO-ET2 are out of scope of RIIO- ET1 closeout.

The RIIO-ET1 licence, paragraph 21 of SpC 6G "Mitigating the impact of Pre-existing Transmission Infrastructure on the visual amenity of Designated Areas", states that Ofgem may revise the EPIE values to "*correct errors in relation to those values, or because the licensee has not Delivered or had only partially Delivered an EPI Output set out in Table 1 of this condition*". Ofgem also states in paragraph 14.4 of the RIIO-T1 Close Out methodology that these projects have experienced a "*failure to deliver during the RIIO-ET1 price control*". We have not failed to deliver any RIIO-T1 outputs as each of the project output delivery dates fall in the RIIO-T2 price control period. Therefore, these three schemes are not in scope under paragraph 6G.21 for Ofgem to downward adjust the RIIO-T1 allowances.

Table 1: VISTA Schemes and Delivery Dates

VISTA Scheme	Delivery Date
Sloy	2022
Glen Falloch	2022
Killin	April 2024

Therefore, we recommend that Ofgem does not adjust the RIIO-T1 allowances for VISTA schemes recognising that the total allowance for each scheme has been provided for between the RIIO-T1 and RIIO-T2 licences.

Furthermore, it is unacceptable for Ofgem to make a downward adjustment to our RIIO-T1 allowances resulting from these COVID-19 delayed projects, without also confirming how and when it will amend the RIIO-T2 allowances upwards by the same value. However, as outlined above, we believe such an adjustment is out of scope of the RIIO-T1 close out process.

Treatment of innovation allowances

Question 19: Do you agree with our proposals?

Yes, we agree with your proposals and are satisfied that associated issues identified in the T2 RRP consultation have been resolved.