

# Decision

## Decision on the assessment of three 2023 SPT's MSIP full applications

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This document sets out our<sup>1</sup> decision following a consultation on the assessment of three of SP Transmission's (SPT's) full applications under the Medium Sized Investment Projects (MSIP) re-opener mechanism.

We published a consultation on 9 October 2023, setting out our assessment and draft determinations concerning three full applications submitted by SPT. The consultation closed on 7 November 2023. This document summarises the responses received and our decision after careful consideration of these responses. We have published non-confidential responses<sup>2</sup> to the consultation alongside this document.

<sup>1</sup> The terms 'we', 'us', 'our' refer to the Gas and Electricity Markets Authority. Ofgem is the office of the Authority.

<sup>2</sup> <https://www.ofgem.gov.uk/publications/consultation-3-spt-2023-msip-applications>

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## **Contents**

<b>1. Introduction .....</b>	<b>4</b>
Context and related publications .....	4
Our decision-making process .....	5
Responses to the consultation .....	5
Our decision-making .....	5
General feedback.....	5
<b>2. SPT’s three MSIP projects .....</b>	<b>7</b>
Background .....	7
Our draft determination .....	7
Consultation responses .....	9
Our views .....	10
Risk and Contingency Allocation .....	10
Opex Escalator .....	13
Staged Approach to MSIP Application.....	13
Contractor indirects .....	14
Publication of commercially sensitive cost information .....	15
Other comments .....	15
Summary of project allowance .....	15
<b>3. Next Steps .....</b>	<b>17</b>

# 1. Introduction

## Context and related publications

1.1. Network companies are natural monopolies. Effective regulation of privatised for-profit monopolies is essential to ensure they cannot unfairly exercise their monopoly power to the detriment of their customers. This is particularly important in the case of essential utilities, such as energy, where consumers have no choice on whether or not to pay what they are charged. It is therefore crucial that an effective regulator protects energy consumers by controlling how much network companies can charge their customers. Ofgem<sup>3</sup> does this through periodic price controls that are designed to ensure network companies are properly incentivised to deliver the best possible outcomes for current and future energy consumers. This includes ensuring that consumers only pay for investments that are needed and do not overpay for those investments.

1.2. SPT is the holder of an electricity transmission licence ('the Licence') granted or treated as granted under section 6(1)(b) of the Electricity Act 1989 ('the Act').

1.3. Special Condition (SpC) 3.14 Medium Sized Investment Projects Re-opener and Price Control Deliverable (MSIPRE<sub>t</sub>) ('MSIP Re-opener') of the Licence is a mechanism that provides Electricity Transmission Owners ('ETOs'), such as SPT, with an opportunity to request additional funding on projects with a value of less than £100m. Applications may only be made on projects where Baseline Allowances have not already been provided, and subject to other qualifying criteria as set out in SpC 3.14.

1.4. In the January 2023 reopener window, SPT submitted eight applications, of which five were initial needs case submissions and three were full applications (i.e. covering both the needs case and costs). We have already published our preliminary determination on the five initial needs case submissions on 20 September 2023.<sup>4</sup> On 9 October 2023, we published the consultation on the assessment and our draft determinations in respect of the three full applications as listed below.

- 1) Coalburn Supergrid Transformer (SGT) Number 4 (SGT4): installation of the 400/132kV SGT4 in Coalburn 400kV Substation to increase the substation capacity for enabling connection of onshore wind generation
- 2) Constraint Management Pathfinder (CMP) - Line End Open (LEO) and Operational Intertrip Scheme (OTS) Modifications: extension of the existing Anglo-Scottish OTS and LEO schemes with modification works at

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<sup>3</sup> The terms 'the Authority', 'Ofgem', 'we', 'us' and 'our' are used interchangeably in this document. The Authority is the Gas and Electricity Markets Authority. Ofgem is the office of the Authority.

<sup>4</sup> [Decision: 5 SP Transmission's 2023 MSIP applications | Ofgem](#)

Strathaven, Crystal Rig, Elvanfoot and Fallago 400kV substations and Wishaw 275kV substation

- 3) Wishaw - Eccles - Torness - Smeaton OTS: installation of the OTS with modification works at the Wishaw, Eccles, Torness, Smeaton, Strathaven, Crystal Rig and Fallago 400kV Substations

1.5. This document is intended to be read alongside:

- Consultation: SP Transmission's 2023 three MSIP applications<sup>5</sup>
- SPT’s MSIP re-opener submission documents<sup>6</sup> on SPT’s website

## **Our decision-making process**

### **Responses to the consultation**

1.6. We received four responses to the consultation. We have carefully considered all views set out in the responses and taken them into account. As the responses are applicable to all projects, a summary of the responses and our views are provided in chapter 2 of this document.

### **Our decision-making**

1.7. The decision-making stages are detailed below:

<b>Date</b>	<b>Stage description</b>
09/10/2023	Stage 1: Consultation opens
07/11/2023	Stage 2: Consultation closes (awaiting decision), Deadline for responses
15/11/2023	Stage 3: Responses reviewed and published
28/02/2024	Stage 4: Decision published

### **General feedback**

1.8. We believe that consultation is at the heart of good policy development. We are keen to receive your comments about this decision document. We’d also like to get your answers to these questions:

1. Do you have any comments about the overall quality of this document?
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?

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<sup>5</sup> <https://www.ofgem.gov.uk/publications/consultation-3-spt-2023-msip-applications>

<sup>6</sup> [https://www.spennergynetworks.co.uk/pages/msip\\_reopeners.aspx](https://www.spennergynetworks.co.uk/pages/msip_reopeners.aspx)

**Decision** – Decision on the assessment of three 2023 SPT's MSIP full applications

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4. Are its conclusions balanced?
5. Did it make reasoned recommendations?
6. Do you have any further comments?

Please send any general feedback comments to [stakeholders@Ofgem.gov.uk](mailto:stakeholders@Ofgem.gov.uk).

## **2. SPT’s three MSIP projects**

### **Background**

2.1. In the January 2023 MSIP Re-opener submission, SPT made submissions in respect of the following projects:

- 1) The Coalburn SGT4 project: It consisted of reconfiguration and reinforcement works at Coalburn 400/132kV Substation and the installation of a new SGT (SGT4). SPT submitted the initial needs case in 2022 and the final needs case and cost information in 2023. The purpose of the project is to increase the substation capacity and to enable the connection of 288MW of contracted onshore wind generation.
- 2) CMP - LEO and OTS Modifications project: The project proposed to develop the Anglo-Scottish OTS and LEO components of the SPT-NGET Interconnector Control Schemes (ICS) and System Integrity Protect Scheme (SIPS) in response to an STCP 16-1 Planning Request received from National Grid Electricity System Operator (NGESO) in respect of their B6 Constraint Management Pathfinder initiative. This project included modification works at Strathaven, Crystal Rig, Elvanfoot and Fallago 400kV substations and Wishaw 275kV substation
- 3) Wishaw - Eccles - Torness - Smeaton OTS project: The project is to develop the Wishaw - Eccles - Torness - Smeaton OTS component of the SPT-NGET ICS and SIPS in response to a draft STCP 16-1 Planning Request received from NGESO in June 2014. This project included modification works at the Wishaw, Eccles, Torness, Smeaton, Strathaven, Crystal Rig and Fallago 400kV Substations.

### **Our draft determination**

2.2. Having considered the evidence given in SPT’s submissions, we published the consultation in October 2023,<sup>7</sup> setting out our assessment and draft determinations on these projects. Our draft determination was that the needs case for each of the projects is valid. Based on the information in the needs case submissions, we are satisfied that there is a need for each of the projects, that SPT has considered all viable options, and that it has correctly rejected all options but one.

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<sup>7</sup> [Consultation: 5 SP Transmission's 2023 MSIP applications | Ofgem](#)

2.3. We therefore proposed in the consultation to accept the needs case for these projects and the preferred option presented by SPT in addressing the needs case.

2.4. We also proposed in the consultation to adjust the funding requests by SPT for these projects to an efficient level by taking out the indirect cost and by reducing the risk allowance as shown in Tables 1 to 3 below. The reasons for the adjustments are (1) indirect cost should be funded through the Opex Escalator mechanism and (2) the risk allocation requested by SPT is higher than the average risk allowance across projects as set out in the RIIO-ET2 Final Determinations (FDs).

**Table 1. The Coalburn SGT4 project**

Cost category	SPT request (£m)	Ofgem adjustment – cost efficiency (£m)	Ofgem adjustment – cost reclassified as indirect (£m)	Ofgem draft determination (£m)
Contractor costs	13.973	0	-1.672	12.300
Risk Allowance	1.186	-0.263	0	0.923
<b>Total</b>	<b>15.159</b>	<b>-0.263</b>	<b>-1.672</b>	<b>13.223</b>

**Table 2. CMP - LEO and OTS Modifications project**

Cost category	SPT request (£m)	Ofgem adjustment – cost efficiency (£m)	Ofgem adjustment – cost reclassified as indirect (£m)	Ofgem draft determination (£m)
Contractor costs	1.297	0	-0.248	1.049
Risk Allowance	0.143	-0.064	0	0.079
<b>Total</b>	<b>1.440</b>	<b>-0.064</b>	<b>-0.248</b>	<b>1.128</b>

**Table 3. Wishaw - Eccles - Torness - Smeaton OTS project**

Cost category	SPT request (£m)	Ofgem adjustment – cost efficiency (£m)	Ofgem adjustment – cost reclassified as indirect (£m)	Ofgem draft determination (£m)
Contractor costs	0.985	0	-0.266	0.718
Risk Allowance	0.104	-0.050	0	0.054
<b>Total</b>	<b>1.089</b>	<b>-0.050</b>	<b>-0.266</b>	<b>0.772</b>



## **Consultation responses**

2.5. We received four responses to the consultation from SPT, National Grid Electricity Transmission plc (NGET), National Grid Electricity System Operator (NGESO) and from one private respondent. We have published the responses alongside this document.<sup>8</sup>

2.6. SPT’s response is summarised in the five areas as below.

- i. Risk and contingency allowance: SPT considered that Ofgem’s use of an average value to cap risk provision is arbitrary and non-project specific. SPT requested Ofgem to share the methodology, with supporting evidence, and project base used to establish the 7.5% cap for the risk. Further, SPT considered that, if Ofgem retains the percentage cap approach to risk, the cap percentage needs to be applied to the project costs including contractor indirects, not to the costs which exclude them.
- ii. Opex Escalator (OE): SPT maintained that Ofgem’s proposed application of the OE represents an error and will result in underfunding across the portfolio of MSIP projects.
- iii. Staged approach to MSIP application: SPT strongly recommended Ofgem retains the two-stage MSIP application approach (consisting of submission of an initial needs case followed by a final needs case and a cost assessment), in order to ensure timely MSIP delivery and to enable the investment needed to achieve the 2030 Net Zero target.
- iv. Contractor indirects: SPT provided further information for both surveys and detailed design costs for the three MSIP projects. SPT requested Ofgem to reconsider that those costs classified as “asset specific design” should be recognised as Direct Costs.
- v. Publication of commercially sensitive cost information: SPT reiterated to Ofgem the importance of the diligence for publication of commercially sensitive cost information.

2.7. NGET’s response is in areas of risk and contingency allowance, OE, staged approach to MSIP application and the publication of commercial sensitive information. NGET’s views in these areas are the same as that of SPT in paragraph 2.6 above.

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<sup>8</sup> [Consultation: 3 SPT 2023 MSIP applications | Ofgem](#)

2.8. NGESO's comments are summarised below.

- i. The Coalburn SGT4 project will increase the export capabilities of a large group of wind farms which are currently restricted at full capacity. The SGT4 will allow the site to be split into two boards with a new additional higher rated SGT.
- ii. The Constraint Management Pathfinder: The works being carried out by SPT will connect further generators to the Anglo-Scottish OTS which will allow the ESO to arm these generators to manage system constraints on the B6 boundary instead of curtailing generation. This will allow more renewable electricity to be generated as constraints on this boundary are strongly correlated with high levels of wind generation. The service so far has delivered savings of £80m in the first year from six units that were already connected and this is expected to continue as a further nine generators are added under the works carried out by SPT. Extending the scheme to include the B7a in NGET's licence area, will allow the service to be used to manage constraints across a greater area of the network, in turn increasing the potential benefits that the service can deliver.

2.9. The other response, from a private individual, did not relate specifically to the project but was a general comment on the effectiveness of the assessment and approval process.

## **Our views**

### **Risk and Contingency Allocation**

2.10. When setting allowances for risk and contingency on re-openers we aim to be consistent with baseline allowances set at RIIO-ET2 Final Determinations. This helps ensure that across the full RIIO-ET2 portfolio that allowances for risk and contingency continue to be set at an appropriate level. When setting baseline allowances we considered the risk and contingency as a proportion of direct project costs on all RIIO-ET2 load and non-load projects that were approved in the FDs. We applied a cap on the risk and contingency allowance on individual projects, that resulted in risk and contingency allowances that averaged 7.5% across the RIIO-ET portfolio. In order to maintain this 7.5% average, we apply the same percentage on re-opener project projects in RIIO-ET2.

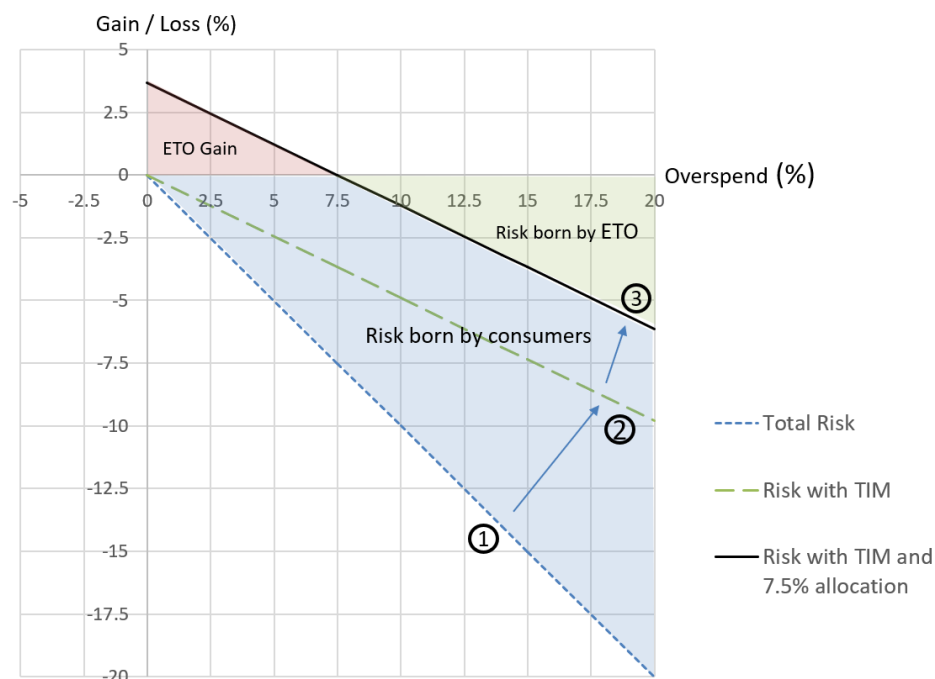
2.11. The current level of 7.5% risk and contingency allocation aims to balance the risk born by the company and risk born by consumers, and considers its interaction with the risk sharing effect of the Totex Incentive Mechanism (TIM).

2.12. The TIM is a RIIO mechanism that incentivises efficient expenditure through providing companies with a share of any underspend or overspend of their total expenditure (totex). The remainder is passed onto consumers. Although the assessed risk on individual projects and across the RIIO-ET2 project portfolio might be higher than the allowances, this is appropriate as the risk sharing effect of the TIM means that the company's actual risk exposure is lower than the assessed level.

2.13. Figure 1 below illustrates SPT's and consumers risk exposures for a 7.5% risk and contingency allowance.

- Line 1: represents the total overspend due to risk factors materialising, where the total loss is equal to the overspend. There is no consideration at this stage of how this loss is shared between the company and consumers.
- Line 2: allows us to understand the effect of the TIM, which apportions the loss between the ETO and consumers according to the Totex Incentive Strength (49% for SPT). Any losses below Line 2 are borne by the consumers, while any losses above it are borne by company.
- Line 3: shows us the outcome of adding a 7.5% risk and contingency allowance to the project direct cost in combination with the TIM. This has the effect of moving Line 2 to the right, and instead of the breakeven point for company being at zero percent over-spend, it is now at 7.5%. This means that materialised risk needs to have a cost of 7.5% of project direct costs before a company experiences any losses. Any risk value of up to 7.5% is borne fully by consumers, with network company gaining for any risks that materialise up to this value. The area shaded in blue represents the risk borne by consumers, which (even before the potential ETO gain (shaded in red) is netted off) is significantly larger than the risk borne by the ETO (area shaded in green).

## Decision – Decision on the assessment of three 2023 SPT’s MSIP full applications



**Figure 1. Risk sharing between ETO and consumers<sup>9</sup>**

2.14. SPT’s requested risk and contingency allocations for the three projects are 9.6%, 13.6% and 14.5% respectively. Table 4 below illustrates the extent of risk shifting in term of sharing of losses when the project cost is overspent due to risk materialising at SPT’s requested levels.

**Table 4. Sharing of Losses by SPT and consumers with risk allowance at 7.5%**

	Overspend due to risk materialised at SPT’s requested level	Sharing of Losses between SPT and consumers (SPT : Consumers)
<b>Coalburn SGT4 project</b>	£1.186m (9.6% of direct cost)	£0.129m : £1.057m (11% : 89%)
<b>CMP Pathfinder project</b>	£0.143m (13.6% of direct cost)	£0.032m : £0.111m (22% : 78%)
<b>Wishaw OTS project</b>	£0.104m (14.5% of direct cost)	£0.025m : £0.079m (24% : 76%)

<sup>9</sup> Negative over-spend (or underspend) is not shown in Figure 1. It is because this is over-spend due to risk factors materialising. In theory, a negative over-spend is not possible as we assumed there is no risk allowances embedded in asset unit costs.

2.15. Furthermore, for any overspend below 7.5%, the ETO will gain financially (as shown in the area shaded in red in Figure 1). This means consumers paid extra money but get nothing back.

2.16. We still consider that the risk and contingency allocation of 7.5% is appropriate at the moment, as it aligns with the position set out by us in RIIO-ET2 FDs. We will collect data on the outturn risk for projects across the price control period. Future allowances will be informed by this data, as well as any evidence indicating that either consumers or network companies are bearing disproportionate levels of risk, or are making unearned gains through risk allocations.

2.17. We do not agree that the 7.5% risk allocation should be applied to the costs including indirect costs, as it is the average of the risk and contingency costs as a percentage of the direct project costs for all load and non-load schemes across the RIIO-ET2 portfolio that was agreed in the FDs.

### **Opex Escalator**

2.18. We published the rationale for the application of OE in our decision on the statutory consultation to modify the NGET licence to give effect to the decision on NGET's 2022 MSIP applications on 6 October 2023.<sup>10</sup>

2.19. Our decision recognised that while sufficient evidence of systematic underfunding does not exist at present, the ETOs may be able to present sufficient ex post evidence at close-out. We therefore proposed a closeout mechanism (OE Review Mechanism) which would allow us, should the ETOs provide strong evidence and robust quantification of systematic underfunding versus efficient levels, to apply appropriate adjustments to the ETOs' RIIO-2 allowances to rectify the issue.

2.20. We are working with the ETOs to finalise the design of the OE Review Mechanism and will take ETOs' representations into account in finalising the Review Mechanism.

### **Staged Approach to MSIP Application**

2.21. In relation to the staged approach to MSIP applications consisting of assessing the initial needs case followed by assessing the final needs case and the cost assessment information, the intention of the MSIP mechanism is to ensure that ETOs have certainty that there is a funding route in RIIO-ET2 for necessary additional work, and for ETOs to apply when they have sufficient certainty in relation to the cost and scope of those

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<sup>10</sup> [Decision to modify the special conditions of the electricity transmission licence held by National Grid Electricity Transmission Plc | Ofgem](#)

works. In our view a single MSIP application is in most cases sufficient to achieve these objectives.

2.22. To address the concern on the availability and certainty of cost information at the MSIP submission date, our view is that, in order to facilitate timely assessment and decision on re-opener applications, we will consider, on case-by-case basis, requests from ETO to provide updated project cost information up to 3 months from the date of the application having been submitted. We will only grant permission in cases where it is genuinely needed (ie. The ETO has already firmed up the project scope with tender returns scheduled within 3 months from the date of the submission of the MSIP application), and provided agreement is sought by the ETO from Ofgem at least two months in advance of its initial submission.

2.23. Furthermore, in the decision on ASTI licence modification,<sup>11</sup> we included an additional authority triggered MSIP submission window in each year for projects that are required to enable delivery of an ASTI project. ETOs should review the relevant project planning windows and inform us if they consider additional windows to be required for ASTI related projects.

### **Contractor indirects**

2.24. In our draft determination published in the consultation document, the adjustments to take out the contractor indirects for the three projects are all based on the breakdown of project costs provided by SPT in the response to our supplementary questions. There is no classification of “asset specific design” in SPT’s response.

2.25. With the further breakdown and classification provided by SPT for the detailed design cost, we have reviewed the classification taking into account our clarification on manufacturing configuration design in the 2022/23 RIGs. We agree that those cost classified as “asset specific design” should be recognised as Direct Costs.

2.26. For the survey cost, according to the RIGs definition, only those surveys for the purposes of flooding are treated as direct. All other survey costs should be classified as indirect costs.

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<sup>11</sup> [Decision to modify the special licence conditions in the electricity transmission licences: Accelerated Strategic Transmission Investment | Ofgem](#)

## **Publication of commercially sensitive cost information**

2.27. We are intending to further develop the redaction policy set out in the Re-opener Guidance<sup>12</sup>. We will separately engage with ETOs and other network companies to seek their views.

## **Other comments**

2.28. We agree with NGESO on the benefits of these projects in making our overall assessment of these projects.

2.29. We have separately responded to the private individual on the comments he made.

## **Summary of project allowance**

2.30. As a result of the reclassification of some costs as Direct Costs as mentioned in paragraphs 2.24 to 2.26, the project allowance is adjusted upwards as shown in tables 5 to 7 below.

2.31. It is noted that for the Coalburn SGT4 project and the Wishaw OTS project, direct expenditure of £0.179m and £0.294m respectively was incurred before the RIIO-ET2 price control period. According to SpC 3.14.9(c), all funding applications under the MSIP re-opener "*must be confined to costs incurred or expected to be incurred on or after 1 April 2021*". Hence, the project allowances for these two projects are adjusted by excluding all pre RIIO-ET2 expenditure. For the avoidance of double adjustments for pre RIIO-ET2 expenditure and contractor indirects, the amount to be removed is reduced by the contractor indirects included in the pre RIIO-ET2 expenditure.

2.32. With the adjusted direct costs for these projects, the risk and contingency allocation of 7.5% of total direct costs are re-calculated accordingly.

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<sup>12</sup> <https://www.ofgem.gov.uk/publications/re-opener-guidance-and-application-requirements-document-version-3>

**Table 5. Allowance for Coalburn SGT4 project**

Cost category	SPT request (£m)	Ofgem draft determination (£m)	Ofgem further adjustment (£m)	Ofgem final determination (£m)
Contractor costs	13.973	12.300	+0.467 <sup>a</sup> -0.050 <sup>b</sup>	12.717
Risk Allowance	1.186	0.923	+0.035	0.958
<b>Total</b>	<b>15.159</b>	<b>13.223</b>	<b>+0.452</b>	<b>13.675</b>

a – Adjustment for reclassification of some costs as Direct Cost

b - Adjustment for removing expenditure incurred in pre-RIIO-ET2 period

**Table 6. Allowance for CMP Pathfinder - LEO and OTS Modifications project**

Cost category	SPT request (£m)	Ofgem draft determination (£m)	Ofgem further adjustment (£m)	Ofgem final determination (£m)
Contractor costs	1.297	1.049	+0.161 <sup>a</sup>	1.210
Risk Allowance	0.143	0.079	+0.012	0.091
<b>Total</b>	<b>1.440</b>	<b>1.128</b>	<b>+0.173</b>	<b>1.301</b>

a – Adjustment for reclassification of some costs as Direct Cost

**Table 7. Allowance for Wishaw - Eccles - Torness - Smeaton OTS project**

Cost category	SPT request (£m)	Ofgem draft determination (£m)	Ofgem further adjustment (£m)	Ofgem final determination (£m)
Contractor costs	0.985	0.718	+0.184 <sup>a</sup> -0.287 <sup>b</sup>	0.615
Risk Allowance	0.104	0.054	+0.014	0.068
<b>Total</b>	<b>1.089</b>	<b>0.772</b>	<b>-0.089</b>	<b>0.683</b>

a – Adjustment for reclassification of some costs as Direct Cost

b - Adjustment for removing expenditure incurred in pre-RIIO-ET2 period



### **3. Next Steps**

3.1. We have taken full account of the consultation responses and made a decision to award funding to SPT for the three MSIP projects as detailed in Chapter 2.

3.2. We will give effect to our decision to award funding and hold SPT to account for delivery of these three projects via the creation of three separate Price Control Deliverables (PCDs) within SPT’s licence. The outputs, delivery dates and allowances for these three PCDs reflect our decisions in this document.

3.3. Alongside this decision document, we have published a statutory consultation to add PCDs in Appendix 1 to SpC 3.14 of SPT’s Licence.

3.4. Our planned timeline for making these proposed licence changes is as follows:

- Publication of statutory consultation to amend SPT’s licence – 28 Feb 2024
- Deadline for receipt of responses to statutory consultation – 2 Apr 2024 (at least 28 days after publication of consultation)
- Decision to modify SPT’s licence – approximately May/Jun 2024
- Licence modifications will come into effect – 56 days after our decision to modify SPT’s licence (subject to consultation responses and if we make the decision to modify the licence).