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Date: 28 May 2008

Dear Colleague

Beaully-Denny Public Inquiry Income Adjusting Event

Background

The Transmission Investment for Renewable Generation (TIRG) mechanism that is currently in place for the three transmission licensees provides funding to connect a large volume of renewable generation that was not forecast at the time the relevant price controls were set for the transmission licensees. The TIRG mechanism, final proposals for which were made in December 2004, resulted in explicit expenditure allowances in the transmission licences for a range of projects. However, it was also recognised that due to the inherently uncertain nature of the volume, displacement and nature of the new connections, various release valves would need to be inserted into the transmission licences to provide a mechanism to correct funding allowances if they proved inappropriate.

The transmission licence sets out the works on each of the transmission owner's systems that fall under the TIRG mechanism. The largest project in TIRG, the upgrade of an existing 132kV transmission line to 400kV between Beaully in the north of Scotland and Denny in central Scotland, is primarily within Scottish Hydro Electric Transmission Ltd's (SHETL) transmission area, although SP Transmission Ltd (SPTL) is responsible for building the southern part of the line in its transmission area. The Beaully-Denny line was referred to public inquiry in February 2007 following objections to the line from statutory consultees in the planning process. Given its primary role in designing Beaully-Denny, SHETL has been called to participate in the public inquiry proceedings. SHETL considers that substantial costs have been incurred as a result of its participation in the public inquiry process, and that it should be entitled to recoup this expenditure under the provisions of the transmission licence.

Special Condition J3 (Restriction on transmission charges: Transmission Investment for Renewable Generation) of SHETL's transmission licence (part A of which is replicated at appendix 3) sets out income adjusting event provisions, whereby the licensee can give notice to the Authority that it considers an event has occurred which has materially increased the costs of the licensee and those costs cannot be recovered under the TIRG revenue allowance. Following consideration of the notice and supporting documentation, the Authority has power to determine that such an event has occurred and to determine what the income adjusting allowance should be, either the amount requested by the licensee, or a different amount, at its discretion.

Licence provisions

Special Condition J3 – Restriction of transmission charges: Transmission Investment for Renewable Generation sets out the legal framework by which, amongst other things, SHETL can give notice to the Authority that it believes, and can provide supporting evidence, that an income adjusting event has occurred in respect of a transmission project.

A TIRG income adjusting event means an event or circumstance occurring in the preconstruction period that the Authority is satisfied causes costs and/or expenses to be incurred or served in relation to a transmission project. Special Condition J3 can be found in appendix 3.

Determination by the Authority that an income adjusting event has occurred and the amount of the allowance does not involve an amendment to the licence condition. Therefore the statutory procedure for making licence modifications by agreement under section 11 Electricity Act 1989 does not apply in this case. After this consultation Ofgem may make a determination under paragraph 4(d) of Special Condition J3 or may seek and consider further information before making a decision. After a determination is made, the Authority must publish a notice stating the income adjustment allowance and giving the reasons for the determination.

Income Adjusting Event Notice

On 30 January 2007, SHETL gave notice to the Authority that it considers that an income adjusting event has occurred in relation to the Beaulieu-Denny public inquiry. On 14 May 2007, SHETL wrote to the Authority again setting out updated information on the costs associated with the public inquiry. SHETL considers that additional pre-construction costs of £2.102 million have already been incurred in 2006/07 and forecast costs of £4.888 million are expected to be incurred in 2007/08, on the assumption the public inquiry concludes in early 2008. SHETL therefore considers that the licence should be changed to reflect these values. Specifically, at the time SHETL provided its notice to the Authority, it was requesting that the $TIRGIncAd_t$ term provided for in Special Condition J3 (Restriction on transmission charges: Transmission Investment for Renewable Generation) should take the values for the years $t=p+1$ and $t=p+2$ (2006/07 and 2007/08) of £2.102 million and £4.888 million respectively. The actual costs equate to £1.973 million and £4.452 million respectively in 2004/05 prices.

June 2007 consultation and subsequent process

Ofgem consulted on this issue in June 2007, setting out preliminary information on SHETL's income adjusting event submission.

The Authority received eighteen responses to the initial consultation in June 2007, which can be found on Ofgem's website at www.ofgem.gov.uk. The majority of respondents considered that the costs associated with SHETL's participation in the Public Inquiry are directly the result of it choosing its own level of participation, and that as it had control over the level of representation it should be exposed to the costs of this choice. Other parties argued that it was unfair SHETL should be entitled to recover its costs from its customers, whilst those who have raised the Public Inquiry were not entitled to do so. The Authority's position in response to these points is set out in the section entitled "*Has there been an income adjusting event?*"

Some parties questioned the need for the Beaulieu-Denny project at all, and suggested that alternative routes, such as a sub-sea cable would be better.

Further respondents questioned the validity of the cost item referred to as "recharge to

third parties". Several respondents questioned whether or not this was a charge to customers. However, as the number included was negative, it does not constitute a charge. Instead, the number described as being "3rd party recharge" is an offsetting charge to SPTL of 10 per cent of the non-legal costs. The rationale for this is that both SHETL and SPTL are involved in building sections of the line. The 10 per cent charge to SPTL reflects the relative responsibility of SHETL and SPTL in building the line.

Five respondents were licensed electricity companies. These respondents were in favour of the income adjustment and stated that the licence provisions clearly enable the material costs incurred by SHETL to be recouped via the income adjusting event mechanism. One respondent stated explicitly that, subject to confirmation that no allowance was made for the public inquiry in the price control (TIRG mechanism), SHETL should be entitled to recover its costs.

Since the June 2007 consultation, Ofgem has obtained further information from SHETL to ensure that the Authority is in a sufficiently robust position to make a determination on the issues. The additional information provided by SHETL includes:

- a. Detailed breakdown of the roles and responsibilities of the various technical and environmental contractors used by SHETL, and associated costs;
- b. Detailed breakdown of the roles and responsibilities of the legal support used by SHETL, and associated costs, and
- c. Provision of detailed tender information for a number of consultants employed.

A summary of the roles and responsibilities of the various parties employed by SHETL can be found at appendix 2, whilst a more detailed breakdown of the costs for 2006/07 can be found at appendix 1.

Ofgem's view following the June 2007 consultation

Having reviewed all of the information available to us, in accordance with the provisions of the licence, and having given consideration to the responses to the June 2007 consultation, we believe that it is appropriate to consult only on the issue of whether the actual costs for 2006/07 should be permitted at this stage. We therefore intend to treat the 2007/08 costs separately when they are confirmed as being "actual". This may be during summer 2008. We consider that this approach will minimise the potential for forecasting error, and will ensure that the costs to which customers are exposed are as robust as possible.

Ofgem's role

As we have stated previously in our June 2007 consultation, it is not the Authority's role to decide whether the Beaulieu-Denny line should be built. That issue is not the subject of this consultation and the points made by respondents in relation to whether or not the Beaulieu-Denny line itself should be allowed to be built are not considered as part of this consultation. It would not be appropriate for any issues relating to the validity of the proposed construction project to be considered as part of this income adjusting event, as it is beyond the scope of the provisions in the licence, under which the income adjusting event has been raised.

However, SHETL's participation in the public inquiry has clearly resulted in costs of representation. These costs are related to the demands placed upon SHETL by the public inquiry, for which funding has not been provided by regulatory means.

The issues for the Authority in considering whether SHETL's costs should be recovered are:

- Whether or not the notice of the income adjusting event given by SHETL to Ofgem complies with the relevant licence provisions at paragraph 4(b) of Special Condition J3;
- Whether a TIRG income adjusting event has occurred; and
- If so, what the amount of the allowance should be, such as to ensure that the financial position and performance of the licensee is, insofar as reasonably practicable, the same as if that income adjusting event had not occurred.

Does the Notice from SHETL comply with the terms of paragraph 4(b) of Special Condition J3?

If a licensee considers that an income adjusting event has taken place, it must give notice to the Authority no longer than three months after the end of relevant year t in which the event has occurred. This condition has been met by SHETL as for 2006/07 it has given notice within relevant year t , and for forecast costs for 2007/08 prior to the beginning of relevant year t . To be clear, SHETL included forecast costs for 2007/08 within the income adjusting event notice as Special Condition J3, paragraph 4(a)(i) permits the licensee to do so. However, we consider that given the potential uncertainty over future costs forecast considerably ahead of time, it would be undesirable for the Authority to potentially permit the licensee to recover significant expenditure, given the possibility that the allowance would be incorrect. We are therefore minded to allow recovery of actual costs, based on the evidence we have been provided with in accordance with the licence conditions. We would therefore expect that SHETL would raise another income adjusting event for 2007/08 when actual costs for that period have been quantified, and in any event before the end of relevant year t plus 3 months, unless a notice from the Authority enables it to notify after this period (in accordance with the licence provisions). The Authority is likely to direct an alternative date to ensure that all relevant costs, which run to June 2008, can be included in a single further submission to the Authority.

Has there been an income adjusting event?

For the Authority to be able to agree that an income adjusting event has occurred in the pre-construction period, the Authority must be satisfied that 3 key criteria have been met:

1. There has been a material increase or decrease to the forecast preconstruction and contingency costs for the transmission investment project i for TIRG relevant years $t=p$ to $t=-1$ compared to the allowance in Schedule C of the licence.
2. These costs have been, or are expected to be, efficiently incurred or saved.
3. These costs can not otherwise be recovered under the TIRG revenue allowance provided under this condition.

Criterion 1: In the case of the issue of materiality in criterion 1, when taking years 2006/07 and 2007/08, the total anticipated cost of the public inquiry is around 2% of the total cost of the Beaulieu-Denny line, and considerably more than the planned preconstruction and contingency costs of £5.1 million (in 2004/05 prices). Evidently the anticipated costs can be considered to be material.

Criterion 2: We have undergone a rigorous audit process of all the cost items submitted by SHETL, including:

- Assessment of the need case for relevant contractors, including legal counsel.

- Assessment of the costs against comparative market rates, appropriateness of duration employed, suitability of contractor to task and justification of need case for task, and confirmation of competitive tender processes for contractors.
- Assessment of the potential for efficiency savings to be made by utilising internal staff rather than contractors.

As part of this process, Ofgem has had sight of detailed tender information relevant to the work undertaken for SHETL in relation to the public inquiry. We have seen contracts for services and the hourly rates SHETL negotiated for particular services. We have compared these rates with publicly available information of comparative services, and where possible have compared rates with our own knowledge of market prices. In certain cases we have explicitly sought justification for the length of time that parties have been employed, and why such roles could not be fulfilled by alternative approaches. Where SHETL has sought funding for internal staff representing SHETL at the public inquiry, we have compared these costs with the counter-factual of consultants being employed to run the project. We are convinced that SHETL diverting its own internal resource to the public inquiry (above and beyond what could reasonably be expected) has resulted in material cost savings that otherwise would have been funded by consumers. The use of internal solicitors for assessing compulsory wayleave applications in particular will have resulted in material cost savings. SHETL has estimated that its use of internal resources to assist counsel has resulted in savings of around £400,000.

We have not identified any areas of costs where we consider that there could have been savings made if an alternative approach was adopted, and therefore consider that SHETL's request for funding in 2006/07 is robust. However, given the bulk of costs for the public inquiry will have been incurred in 2007/08, we will continue to rigorously look for cost savings in subsequent submissions.

The tender and contracts information is confidential for commercial reasons and can not be disclosed for the purposes of this consultation.

Criterion 3: As part of Ofgem's financial assessment work under the TIRG mechanism, at the time of implementation, SHETL was not provided an ex-ante allowance for the costs of defending public inquiries. We would therefore consider that given no such ex-ante allowance has been approved by the Authority, that the costs incurred by SHETL cannot be recovered elsewhere under the TIRG revenue allowance. We therefore consider that criterion 3 is met.

The Authority takes the view that all relevant criteria appear to be met, and the provisions of Special Condition J3, paragraph 4, have also been adhered to. Subject to this consultation and consideration of respondents' views, we are minded to make a determination that the licensee should be able to recover the costs associated with the Beaulieu-Denny Public Inquiry Income Adjusting Event.

What should the adjustment be?

It should be noted that since the June 2007 consultation, our further analysis of SHETL's submissions has identified that certain costs were allocated to 2006/07 and others to 2007/08 on the basis of when expense claims were submitted rather than when the costs were actually incurred. As a result there are some small changes to the levels of costs in some key areas, notably legal counsel. However, these small variations do not affect the total value of the income adjusting event claim for 2006/07, which remains at £2.1 million in 2006/07 prices.

Next steps

We would like to hear the views of any interested parties regarding the issues raised in this letter. Responses should be made on or before 09 July 2008 to:

David Hunt
Senior Manager – Electricity Transmission Policy
Office of Gas and Electricity Markets
9 Millbank
London SW1P 3GE

or by email to david.hunt@ofgem.gov.uk.

Following closure of this open letter consultation, and careful consideration of respondents' views, the Authority may make a determination under paragraph 4(d) of Special Condition J3 or may seek and consider further information before making a decision. If a determination is made, the Authority will publish a notice stating the income adjustment allowance and giving the reasons for the determination.

Yours faithfully,

A handwritten signature in black ink, appearing to be 'Steve Smith', with a stylized, cursive script.

Steve Smith
Managing Director - Networks

Appendix 1 – detailed breakdown of costs incurred in 2006/07

Table 1 – Beaully-Denny Public Inquiry Income Adjusting Event Incurred Costs for 2006/07 in money of the day (nominal prices)

	Item	2006/07
		£
	Environmental Consultants	
1	Agriculture Consultants	
2	Archaeology Consultants	
3	Ecology Consultants	
4	Ecology Consultants for Designated Areas	
5	Forestry Consultants	
6	General Environmental Advice and ES Production Advice	
7	Geology and Hydrology Consultants	
8	Lead Environmental Consultant on Project (Landscape Architect)	
9	Landscape Architect	
10	Planning Policy Consultants	
11	Tourism and Recreation Consultants	
12	Visualisation and Photomontage Production	
	Sub-Total	1,013,841
	Internal Team Costs	
13	SHETL Internal Public Inquiry Team	
	Sub-Total	264,999
	Legal Costs	
14	Assisting Instructing Solicitor	
15	Assisting Leading Counsel	
16	External Legal Services - Compulsory Purchase Orders	
17	Leading Counsel	
	Sub-Total	439,817
	Technical Consultants	
18	Cable and Undergrounding Consultants	
19	Economic and Engineering Justification for the Project	
20	Electromagnetic Field (EMF) Consultant	
21	Environmental Consultant - Heat Dissipation in Soils Report (with Respect to Undergrounding)	
22	Operational Noise Surveyors	
23	Technical Consultancy and Public Inquiry Witness	
	Sub-Total	415,015
	Other Costs	
24	Advertise Public Inquiry	
25	Consultant Travel and Accommodation	
26	Costs to be Recovered from SP Transmission Ltd	
27	External Copying and File Collation for Strategy Documents	
	Sub-Total	-31,809
	Grand Total	2,101,864

Table 2 – Beaulay-Denny Public Inquiry Income Adjusting Event Incurred Costs for 2006/07 in 2004/05 prices

	Item	2006/07
		£
	Environmental Consultants	
1	Agriculture Consultants	951,997
2	Archaeology Consultants	
3	Ecology Consultants	
4	Ecology Consultants for Designated Areas	
5	Forestry Consultants	
6	General Environmental Advice and ES Production Advice	
7	Geology and Hydrology Consultants	
8	Lead Environmental Consultant on Project (Landscape Architect)	
9	Landscape Architect	
10	Planning Policy Consultants	
11	Tourism and Recreation Consultants	
12	Visualisation and Photomontage Production	
	Sub-Total	
	Internal Team Costs	
13	SHETL Internal Public Inquiry Team	248,834
	Sub-Total	
	Legal Costs	
14	Assisting Instructing Solicitor	412,988
15	Assisting Leading Counsel	
16	External Legal Services - Compulsory Purchase Orders	
17	Leading Counsel	
	Sub-Total	
	Technical Consultants	
18	Cable and Undergrounding Consultants	389,699
19	Economic and Engineering Justification for the Project	
20	Electromagnetic Field (EMF) Consultant	
21	Environmental Consultant - Heat Dissipation in Soils Report (with Respect to Undergrounding)	
22	Operational Noise Surveyors	
23	Technical Consultancy and Public Inquiry Witness	
	Sub-Total	
	Other Costs	
24	Advertise Public Inquiry	-29,868
25	Consultant Travel and Accommodation	
26	Costs to be Recovered from SP Transmission Ltd	
27	External Copying and File Collation for Strategy Documents	
	Sub-Total	
	Grand Total	1,973,650

Appendix 2 – Roles and responsibilities of contracted resources– a note produced by SHETL

Engagement with the Public Local Inquiry

Scottish Hydro Electric Transmission Limited (SHETL), as the applicant, has to be represented at all sessions of and on all aspects of the Public Local Inquiry (PLI). This includes, for example, representation at the strategy session; four local sessions of the inquiry; confidential and conditions' sessions; conjoined wayleave and compulsory purchase order (CPO) hearings; associated (and "called in") planning applications; and site visits.

In order to ensure continuity and to maintain sufficient resource in preparation for the inquiry and throughout the lengthy and intense 10 month PLI this has meant planning for additional legal support to join the team at key points throughout the process. The timetable for the preparation and provision of documents, evidence and appearance at each of the five sessions of the PLI is particularly challenging. In addition to the requirements for legal support during this process the work undertaken by environmental and technical consultants is over-and-above the work completed for the Environmental Statement and the provision of evidence to and appearance at the PLI.

Further information about the work undertaken by the legal team and environmental and technical consultants is provided below.

The main demands of the section 37 application process is on legal services and much of this work is being carried out by the in-house legal team consisting of 1 senior solicitor and a trainee. The team have responsibility for the submission of all documentation for the PLI including precognitions and technical submissions. In addition, the legal team are carrying out all the work required for necessary wayleave applications, involving some 130 wayleave applications.

The in-house 'instructing' legal team has been supported since early January 2007 by the full-time secondment of one assisting solicitor from an external legal firm. In addition, external land search agents have been used to assist in clarifying the extent of land interests as may be affected in relation to the 220km project. Further legal services with regard to advice and drafting in relation to CPOs has been supplied by this legal firm.

It should be noted that it is usual practice for parties wishing to be represented by Counsel at public inquiries, to instruct an external firm of solicitors to deal directly with and respond to Counsels' requests. For a public inquiry of this scale, it would not be unusual for such a firm of solicitors to second to the project a partner, senior associate and number of qualified solicitors together with a large administrative team. In this instance, SHETL chose to staff the project on the basis that the Counsel working with the team are experienced Counsel who would be able to provide both strategic and legal advice with regard to the PLI and its process.

Advocacy Services

SHETL has engaged one Senior Counsel and one assisting Junior Counsel throughout the section 37 application process. Their time on the project increased in the run up to the announcement of a PLI and has, effectively, been on a full time basis since summer 2006.

Prior to the commencement of the PLI, the key areas of work for Counsel included: review of additional information and addenda to the previously submitted Environmental

Statement; preparation of a written submission on proposed PLI process and procedure; and providing guidance and preparation for the pre-inquiry and inquiry process. During the PLI, services provided by the Senior and Junior Counsel have included: appearance at pre-inquiry meetings; submission of statements of case; consultations with witnesses; preparation of evidence; appearance at the PLI; leading evidence; cross examination of other parties witnesses; and preparation of legal submissions as requested by the Reporters.

An additional assisting Junior Counsel was engaged on commencement of the PLI in February 2007. The assisting Junior Counsel undertakes consultation with witnesses and legal note taking, leaving senior Counsel free to concentrate on conducting the inquiry. Detailed and accurate note taking of the proceedings is essential to inform their examination of witnesses, their understanding of the issues which arise and the content of the closing submissions which are prepared at the end of each session of the PLI. This level of advocacy support is in our view consistent and appropriate for an inquiry of this size and complexity.

The structure of the inquiry, with the strategic and local sessions running for the most part sequentially, means that in addition to being represented at each of the sessions, SHETL and its legal team has to meet the demands of further information for the Reporters and respond to issues and alternatives raised by other inquiry parties. Significant work is also required to prepare for subsequent hearings. For example, dates of submission of documentation and precognitions for the Perth and Kinross local sessions are during September 2007 which is the period during which the Cairngorm National Park local session is being held. The coincident nature of the PLI programme, in particular, means that SHETL's Counsel team require to be sufficiently resourced to allow for representation at a local session and preparation for subsequent sessions. We would contrast this with the limited and more selective approach to representation and preparation that can be adopted by other PLI parties.

Environmental Services

Environmental consultants working on the project can be split into the following eight categories with the main areas of work in each category shown below.

- Route Selection and Environmental Impact Assessment Methodology.
- Landscape and Visual.
 - Assessment of effects on landscape and visual interests.
 - Provision of visualisations, maps, plans, etc.
- Archaeology and Cultural Heritage.
 - Identification of effects on cultural heritage.
 - Sheriffmuir Battle Field survey and report.
- Ecology (Mammals and other animals / Birds / Habitats and rare plants).
 - Extensive field survey work.
 - Bird collision risk model development and application.
 - Significance of effects with respect to protected areas.
- Hydrology / Geology and Soils.
 - Assessment of effects on private water supplies.
 - Input to generic and specific undergrounding reports.
 - Report on the effects of heat dissipation on vegetation reestablishment.
- Forestry / Landscape Design.
 - Assessment of overall effect on forestry.

- Development of proposed mitigation measures.
 - Development of forest landscape concept design for application along line route.
- Tourism and Recreation / Agriculture and Sporting Interests.
 - Assessment of effect on tourism and other land interests.
- Planning Policy.

Technical Services

Technical consultants working on the project can be split into the following six categories with the main areas of work in each category shown below.

- Need / Economic Case and Basis of Funding Approval.
- Overhead Tower and Line Design and Construction Activities.
 - Design activities and evidence associated construction of the project.
- Traffic and Access Track Methodology.
 - Assessment of the effects of construction traffic on the roads network including mitigation and improvement works.
 - Development of access track methodology.
- Undergrounding (Environmental Issues / Engineering Issues and Costing).
 - Generic papers on AC and DC undergrounding including sub-sea.
 - Project specific report on use on underground cable as an alternative to overhead line at specific locations.
 - Assessment of other parties' alternative undergrounding proposals.
- Electric and Magnetic Fields.
 - Assessment and presentation of the science of electric and magnetic fields associated with the proposed project.
- Operational Noise.
 - Assessment of operational noise / proximity of properties along the line route.

All of the consultants have been required to be available during the PLI process, to appear as required and to carry out further survey work, respond to alternatives and issues raised by PLI parties and prepare additional evidence. In an inquiry of this length and complexity, this has been and continues to be a significant resource requirement, involving substantial costs.

Appendix 3 – Part A of SHETL’s Special Condition J3

Special Condition J3 – Restriction of transmission charges: Transmission Investment for Renewable Generation

Part A – TIRG Revenue allowance

- 1 For the purposes of paragraph 3 of special condition J2 (Restriction of transmission charges: revenue from transmission owner services) for each TIRG relevant year t, $TIRG_t$ shall be calculated in accordance with the following formula:

$$TIRG_t = \sum_{all\ i} TIRG_t^i$$

where $TIRG_t^i$ means the annual revenue allowance in TIRG relevant year t for each transmission investment project i specified in Schedule C.

- 2 For each TIRG relevant year t, the annual revenue allowance for each transmission investment project i specified in Schedule C shall be calculated in accordance with the following formula:

$$TIRG_t^i = IPTIRG_t^i + TIRGIncAd_t^i + FTIRG_t^i + ETIRG_t^i + ATIRG_t^i$$

where:

$IPTIRG_t^i$ means the annual preconstruction and contingency revenue allowance for the transmission investment project i for the TIRG relevant years $t=p$ to $t=-1$ (where $p \leq -1$) and shall be calculated in accordance with paragraph 3.

$TIRGIncAd_t^i$ means the sum of one or more preconstruction and contingency revenue allowance adjustments for a TIRG income adjusting event and each revenue allowance adjustment shall be determined by the Authority in accordance with paragraph 4.

FTIRG_tⁱ means the annual construction revenue allowance for the transmission investment project i for the TIRG relevant years t=0 to t=n and shall be calculated in accordance with paragraph 5.

ETIRG_tⁱ means the annual incentive revenue allowance for the transmission investment project i for the TIRG relevant years t=n+1 to t=n+5 and shall be calculated in accordance with paragraph 7.

ATIRG_tⁱ means the actual annual revenue allowance for the transmission investment project i for the TIRG relevant years t=n+6 to t=n+20 and shall be determined by the Authority in accordance with paragraph 9.

3 For the purposes of paragraph 2, the term IPTIRG_tⁱ shall be calculated in accordance with the following formula:

$$\text{IPTIRG}_t^i = \text{CFTIRG}_t^i * \text{ARPI}_t$$

where:

CFTIRG_tⁱ means the forecast preconstruction and contingency costs for the transmission investment project i for TIRG relevant years t=p to t=-1 (where p≤-1) and shall have the value specified in Schedule C for each TIRG relevant year t, and where no value is specified in Schedule C for a TIRG relevant year t shall have the value of zero.

ARPI_t means the price index adjustment, which in the relevant year commencing 1 April 2004 equals 1, and in all subsequent years is derived from the following formula:

$$\text{ARPI}_t = \left[1 + \frac{\text{RPI}_t}{100} \right] \times \text{ARPI}_{t-1}$$

where:

RPI_t means the percentage change (whether of a positive or a negative value) in the arithmetic average of the Retail Price Index numbers published or determined with respect to each of the six months from May to October (both inclusive) in relevant year $t-1$ and that is published or determined with respect to the same months in relevant year $t-2$.

- 4 (a) For the purposes of this paragraph, a TIRG income adjusting event means an event or circumstance occurring in the preconstruction period that the Authority is satisfied causes costs and/or expenses to be incurred or saved in relation to the transmission investment project i , where the Authority is satisfied that those costs and/or expenses:
- (i) have resulted in, or are expected to result in, a material increase or decrease to the forecast preconstruction and contingency costs for the transmission investment project i for TIRG relevant years $t=p$ to $t=-1$ (where $p \leq -1$) ($CFTIRG_t$);
 - (ii) have been, or are expected to be, efficiently incurred or saved; and
 - (iii) can not otherwise be recovered under the TIRG revenue allowance provided under this condition.
- (b) Where the licensee considers, and can provide supporting evidence that, a TIRG income adjusting event has occurred in respect of the transmission investment project i , then the licensee shall give notice of that event to the Authority as soon as is reasonably practicable after that event has occurred and in any event no longer than 3 months after the end of the TIRG relevant year t in which that event has occurred (or such later date as the Authority notifies to the licensee for the purposes of this subparagraph).
- (c) A notice provided under subparagraph (b) shall give particulars of:
- (i) the $TIRG_t$ income adjusting event to which the notice relates and the reason(s) why the licensee considers that event to be a $TIRG_t$ income adjusting event;

- (ii) the costs and/or expenses that the licensee can demonstrate have been, or are expected to be, incurred or saved by that event and how the amount of those costs and/or expenses have been calculated;
 - (iii) the amount of any material increase or decrease in the forecast preconstruction and contingency costs for the transmission investment project i for TIRG relevant years $t=p$ to $t=-1$ (where $p \leq -1$) ($CFTIRG_t$) that the licensee can demonstrate have been, or are expected to be, incurred or saved by that event and how the amount of that increase or decrease has been calculated;
 - (iv) the reasons why the licensee considers that the costs and/or expenses can not otherwise be recovered under the TIRG revenue allowance provided by this condition;
 - (v) the amount of any $TIRGIncAd_t^i$ income adjustment allowance proposed as a consequence of that event and how this $TIRGIncAd_t^i$ income adjustment allowance has been calculated; and
 - (vi) any other analysis or information which the licensee considers to be relevant to the Authority's assessment of that event.
- (d) Where the Authority receives a notice under subparagraph (b), the Authority shall determine (after consultation with the licensee and such other persons it considers necessary):
- (i) whether a TIRG income adjusting event has occurred in respect of the transmission investment project i ; and
 - (ii) a $TIRGIncAd_t^i$ income adjustment allowance in respect of the transmission investment project i .
- (e) Where the Authority determines under subparagraph (d) that a TIRG income adjusting event has occurred in respect of the transmission investment project i , the $TIRGIncAd_t^i$ income adjustment allowance in respect of the transmission investment project i determined by the Authority under subparagraph (d) shall be such as to ensure that the financial position and performance of the licensee is, insofar as is reasonably practicable, the same as if that TIRG income adjusting event had not occurred, and in all other cases the $TIRGIncAd_t^i$ income adjustment allowance in respect of the transmission

investment project i determined by the Authority under subparagraph (d) shall be zero.

- (f) Where the Authority makes a determination under this paragraph, the Authority shall publish a notice stating the $TIRGIncAd_t^i$ income adjustment allowance for the transmission investment project i and the reasons for the determination.
- (g) The Authority may revoke a determination made under this paragraph with the consent of the licensee.
- (h) For the purpose of paragraph 2, the term $TIRGIncAd_t^i$ shall be the $TIRGIncAd_t^i$ income adjustment allowance for the transmission investment project i determined by the Authority under subparagraph (d), and where the Authority has not made a determination under subparagraph (d) shall be zero.
- (i) Where the licensee notifies the Authority of a TIRG income adjusting event under subparagraph (b), the licensee shall ensure that the costs and/or expenses that are the subject of that notification are not also notified to the Authority in relation to any other revenue recovery arrangements.

5 For the purposes of paragraph 2, the term $FTIRG_t^i$ shall be calculated in accordance with the following formula:

$$FTIRG_t^i = CCTIRG \times (FTIRGC_t^i + AFFTIRG_t^i) \times ARPI_t + (FTIRGDepn_t^i + AFFTIRGDepn_t^i) \times ARPI_t$$

where:

CCTIRG means the pre-tax cost of capital in real terms for the transmission investment project i for each TIRG relevant year t and for the purposes of this special condition shall take the value of eight point eight per cent (8.8%).

$FTIRGC_t^i$ means the average asset value for the transmission investment project i for each of the TIRG relevant years t=0 to t=n and shall be determined as follows:

- (a) where the licensee has not been granted planning consent to build the transmission investment project i, $FTIRGC_t^i$ shall be zero; and
- (b) where the licensee has been granted planning consent to build the transmission investment project i, $FTIRGC_t^i$ shall have the value specified in Schedule C for each TIRG relevant year t, and where no value is specified in Schedule C for a TIRG relevant year t shall have the value of zero.

$AFFTIRG_t^i$ means one or more adjustments to the average asset value for the transmission investment project i for the TIRG relevant years $t=0$ to $t=n$ ($FTIRGC_t^i$) as a result of a TIRG asset value adjusting event and each adjustment shall be determined by the Authority in accordance with paragraph 6.

$ARPI_t$ shall have the meaning given in paragraph 3.

$FTIRGDepn_t^i$ means the depreciation value for the transmission investment project i for each of the TIRG relevant years $t=0$ to $t=n$ and shall be determined as follows:

- (a) where the licensee has not been granted planning consent to build the transmission investment project i, $FTIRGDepn_t^i$ shall be zero; and
- (b) where the licensee has been granted planning consent to build the transmission investment project i, $FTIRGDepn_t^i$ shall have the value specified in schedule C for each TIRG relevant year t, and where no value is specified in Schedule C for a TIRG relevant year t shall have the value of zero.

$AFFTIRGDepn_t^i$ means one or more adjustments to the depreciation value for the transmission investment project i for the TIRG relevant years $t=0$ to $t=n$ ($FTIRGDepn_t^i$) as a result of a TIRG asset value adjusting event and each adjustment shall be determined by the Authority in accordance with paragraph 6.

- 6 (a) For the purpose of this paragraph, a TIRG asset value adjusting event means

relevant additional preconstruction works or a relevant amendment to the scope of construction works that the Authority is satisfied is expected to cause costs and/or expenses to be incurred or saved in relation to the transmission investment project i, where the Authority is satisfied that those costs and expenses:

- (i) are expected to result in a material increase or decrease to the average asset value for the transmission investment project i for the TIRG relevant years $t=0$ to $t=n$ ($FTIRGC_t^i$);
 - (ii) are expected to be efficiently incurred or saved; and
 - (iii) cannot otherwise be recovered under the TIRG revenue allowance provided by this condition.
- (b) For the purposes of subparagraph (a)–
 - (i) “relevant additional preconstruction works” means preconstruction works expected to be carried out by the licensee during the TIRG relevant years $t=0$ to $t=n$ as a result of the terms and/or conditions of any statutory consent, approval or permission in respect of the transmission investment project i (including but not limited to planning consent); and
 - (ii) “relevant amendment to the scope of construction works” means an amendment to the scope of construction works that:
 - (aa) is necessary to comply with the terms and/or conditions of any statutory consent, approval or permission in respect of the transmission investment project i (including but not limited to planning consent); or
 - (bb) is necessary to comply with technical, engineering or planning constraints in respect of the transmission investment project i that are identified by the licensee during preconstruction work.

- (c) Where the licensee considers, and can provide supporting evidence that, a TIRG asset value adjusting event has occurred in relation to the transmission investment project i , then the licensee shall give notice of that event to the Authority as soon as is reasonably practicable after that event has occurred and in any event prior to TIRG relevant year $t=0$ (or at such later date as the Authority notifies to the licensee for the purposes of this subparagraph).
- (d) A notice provided under subparagraph (c) shall be accompanied by a statement from independent technical advisors setting out the additional preconstruction works / amended scope of construction works (as appropriate) and a statement from independent auditors setting out that in their opinion the notice fairly presents the costs and expenses expected to be incurred or saved by the additional preconstruction works / amended scope of construction works (as appropriate) and shall give particulars of:
- (i) the TIRG asset value adjusting event to which the notice relates and the reason(s) why the licensee considers that event to be a TIRG asset value adjusting event;
 - (ii) the costs and/or expenses that the licensee can demonstrate are expected to be incurred or saved by that event and how the amount of those costs and/or expenses have been calculated;
 - (iii) the amount of any material increase or decrease in the average asset value for the transmission investment project i for TIRG relevant years $t=0$ to $t=n$ ($FTIRGC_t$) that the licensee can demonstrate is expected to occur as a result of that event and how the amount of that increase or decrease has been calculated;
 - (iv) the reasons why the licensee considers that the costs and/or expenses can not otherwise be recovered under the TIRG revenue allowance provided by this condition;
 - (v) the amount of any $AFFTIRG_t^i$ adjustment proposed as a consequence of that event and how this $AFFTIRG_t^i$ adjustment has been calculated;
 - (vi) the amount of any increase or decrease in the depreciation value for the transmission investment project i for the TIRG relevant

- years $t=0$ to $t=n$ ($FTIRGDepn_t^i$) that the licensee can demonstrate is expected to occur as a result of that event and how the amount of that increase or decrease has been calculated;
- (vii) the amount of any $AFFTIRGDepn_t^i$ adjustment proposed as a consequence of that event and how this $AFFTIRGDepn_t^i$ adjustment has been calculated; and
 - (viii) any other analysis or information which the licensee considers to be relevant to the Authority's assessment of that event.
- (e) Where the Authority receives a notice under subparagraph (c), the Authority shall determine (after consultation with the licensee and such other persons it considers necessary):
- (i) whether a TIRG asset value adjusting event has occurred in respect of the transmission investment project i;
 - (ii) where the Authority determines that a TIRG asset value adjusting event has occurred in respect of the transmission investment project i, whether the transmission investment project i will remain economically efficient as a consequence of that TIRG asset value adjusting event;
 - (iii) a $AFFTIRG_t^i$ adjustment in respect of the transmission investment project i; and
 - (iv) a $AFFTIRGDepn_t^i$ adjustment in respect of the transmission investment project i.
- (f) Where the Authority determines under subparagraph (e) that a TIRG asset value adjusting event has occurred in respect of the transmission investment project i and that the transmission investment project i will remain economically efficient as a consequence of that TIRG asset value adjusting event, the $AFFTIRG_t^i$ and $AFFTIRGDepn_t^i$ adjustments in respect of the transmission investment project i determined by the Authority under subparagraph (e) shall be such as to ensure that the financial position and performance of the licensee is, insofar as is reasonably practicable, the same as if that TIRG asset value adjusting event had not occurred, and in all other

cases the $AFFTIRG_t^i$ and $AFFTIRGDepn_t^i$ adjustments in respect of the transmission investment project i determined by the Authority under subparagraph (e) shall be zero.

- (g) Where the Authority makes a determination under this paragraph, the Authority shall publish a notice stating the $AFFTIRG_t^i$ and $AFFTIRGDepn_t^i$ adjustments for the transmission investment project i and the reasons for the determination.
- (h) The Authority may revoke a determination made under this paragraph with the consent of the licensee.
- (i) For the purpose of paragraph 5, the terms $AFFTIRG_t^i$ and $AFFTIRGDepn_t^i$ shall be the $AFFTIRG_t^i$ and $AFFTIRGDepn_t^i$ adjustments for the transmission investment project i determined by the Authority under subparagraph (e), and where the Authority has not made a determination under subparagraph (e) shall be zero.
- (j) Where the licensee notifies the Authority of a TIRG asset value adjusting event under subparagraph (c), the licensee shall ensure that the costs and/or expenses that are the subject of that notification are not also notified to the Authority in relation to any other revenue recovery arrangements.

7 For the purpose of paragraph 2, the term $ETIRG_t^i$ shall be calculated in accordance with the following formula:

$$ETIRG_t^i = (CCTIRG \times (ETIRGC_t^i \times SAFRTIRG^i) \times ARPI_t) + (Dep_t^i \times SAFRTIRG^i \times ARPI_t)$$

where:

CCTIRG shall have the meaning given in paragraph 5.

$ETIRGC_t^i$ means the average asset value for the transmission investment project i for each of the TIRG relevant years $t=n+1$ to $t=n+5$ and shall have the value specified in Schedule C for each TIRG

relevant year t , and where no value is specified in Schedule C for a TIRG relevant year t shall have the value of zero.

SAFRTIRG^i means an adjustment factor to the average asset value for the transmission investment project i for each of the TIRG relevant years $t=n+1$ to $t=n+5$ (ETIRGC_t) and shall have the value of 1 unless otherwise determined by the Authority by TIRG relevant year $t=n+1$ in accordance with the following formula:

$$\text{SAFRTIRG}^i = [\text{SAFTIRG}^i / \text{ETIRGORAV}^i]$$

where:

SAFTIRG^i means the opening asset value for the transmission investment project i determined by the Authority by TIRG relevant year $t=n+1$ in accordance with paragraph 8.

ETIRGORAV^i means the opening regulated asset value for the transmission investment project i at TIRG relevant year $t=n+1$ and shall have the value specified in Schedule C.

ARPI_t shall have the meaning given in paragraph 3.

Dep_t^i means the annual depreciation allowance for TIRG relevant year t and shall have the value specified in Schedule C.

- 8 (a) The Authority shall determine (in consultation with the licensee and such other persons it considers necessary) the value of the term SAFTIRG^i with respect to the transmission investment project i by TIRG relevant year $t=n+1$ where the Authority has received a post construction expenditure report and a post construction technical report in respect of the transmission investment project i in accordance with paragraph 10.

(b) Where the Authority makes a determination under this paragraph, the Authority shall have regard to the following:

- (i) whether the final aggregate transmission investment expenditure set out in the post construction expenditure report has been efficiently

incurred;

- (ii) the extent to which the licensee has complied with the output measures specified in Schedule C for the transmission investment project i as set out in the post construction technical report;
- (iii) whether an adjustment has been made to the average asset value for the transmission investment project i for the TIRG relevant years $t=0$ to $t=n$ under paragraph 6 (AFFTIRG $_t^i$ adjustment);
- (iv) whether an adjustment has been made to the depreciation value for the transmission investment project i for the TIRG relevant years $t=0$ to $t=n$ under paragraph 6 (AFFTIRGDepn $_t^i$ adjustment); and
- (v) any other information the Authority considers to be relevant to the determination.

(c) Where the Authority makes a determination under this paragraph, the Authority shall publish a notice stating the SAFTIRG i opening asset value for the transmission investment project i and the reasons for the determination.

(d) The Authority may revoke a determination made under this paragraph with the consent of the licensee.

- 9 For the purposes of paragraph 2, the term ATIRG $_t^i$ shall be determined by the Authority (in consultation with the licensee and such other persons the Authority considers necessary) by TIRG relevant year $t=n+5$ in accordance with the principle that efficiently incurred costs shall be recoverable by the licensee.