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Date: 10 September 2008

Dear Colleague,

**DETERMINATION AND NOTICE UNDER SPECIAL CONDITION J3 – RESTRICTION OF TRANSMISSION CHARGES: TRANSMISSION INVESTMENT FOR RENEWABLE GENERATION OF THE ELECTRICITY TRANSMISSION LICENCE OF SCOTTISH HYDRO ELECTRIC TRANSMISSION LIMITED (SHETL)**

*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, location and nature of the new connections, the transmission licences would need to provide a mechanism to correct funding allowances if they proved inappropriate.

The transmission licence defines 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 SHETL's transmission area, although SP Transmission Limited (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 of transmission charges: Transmission Investment for Renewable Generation) of SHETL's transmission licence 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.

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 a determination is made, the Authority must publish a notice stating the income adjustment allowance and giving the reasons for the determination. This document constitutes notice of such a 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 of 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*

Ofgem consulted on this issue in June 2007<sup>1</sup>, 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](http://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. 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.

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<sup>1</sup> This consultation can be found at the following link:  
[http://www.ofgem.gov.uk/Networks/Trans/ElecTransPolicy/TIRG/Documents1/070625\\_Ex\\_Open%20Letter%20BD%20Public%20Inquiry%20Costs\\_FINAL.pdf](http://www.ofgem.gov.uk/Networks/Trans/ElecTransPolicy/TIRG/Documents1/070625_Ex_Open%20Letter%20BD%20Public%20Inquiry%20Costs_FINAL.pdf)

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 "3<sup>rd</sup> party recharge" is an offsetting charge to SPTL of 10 per cent of the non-legal costs because 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.

As we 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 process. Accordingly, 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.

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.

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.

#### *The May 2008 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.

On 28 May 2008, the Authority published a consultation<sup>2</sup> stating that it intended to permit SHETL to recover the costs it had incurred in 2006/07 in representing itself at the public inquiry, setting out in detail the rationale for the Authority's position. The notice stated that the Authority intended to allow £2.102 million in nominal prices (£1.973 million in 2004/05 prices) for costs incurred in 2006/07. The rationale for this decision was that the income adjustment "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." In the May 2008 Consultation we explain that we consider all the relevant criteria for determining the value of TIRGIncAd<sub>t</sub>

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<sup>2</sup> This consultation can be found at the following link:  
[http://www.ofgem.gov.uk/Networks/Trans/ElecTransPolicy/TIRG/Documents1/080527\\_BD%20PI%20IAE%20Consultation\\_FINAL.pdf](http://www.ofgem.gov.uk/Networks/Trans/ElecTransPolicy/TIRG/Documents1/080527_BD%20PI%20IAE%20Consultation_FINAL.pdf)

have been met in accordance with the relevant licence provisions, and intend to determine an income allowance, in accordance with the following criteria:

- 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.

The Authority received two responses to the consultation. Both parties agree that additional costs have been incurred as a result of the public inquiry, and that these should be recoverable in full by SHETL in accordance with the relevant licence conditions. Both respondents consider that all relevant criteria have been met and that no further cost savings can be identified. These responses are available on Ofgem's website [www.ofgem.gov.uk](http://www.ofgem.gov.uk).

### **Extension to Submission Deadline for 2007/08 Cost Information**

Following further conversations with SHETL, we have discussed the benefits of the 2007/08 costs being audited and understand from SHETL that it is currently doing so. Prior to this audit being completed, final tenders and other financial information need to be supplied and evaluated. It is our understanding that this process can take several months beyond the relevant financial year. On 7 March 2008, SHETL requested that the Authority provides a notification in accordance with paragraph 4(b) of Special Condition J3 to extend the deadline for submission of a revised notice with supporting evidence, as it believes the requisite information will not be available within the three month period following the end of the relevant year (2007/08).

On 31 July 2008, and in accordance with paragraph 4(b) of Special Condition J3, the Authority agreed that the notice in relation to costs incurred in the Beaulieu-Denny Public Inquiry Income Adjusting Event can be submitted to the Authority by 30 September 2008. As a consequence, this letter focuses on the adjustment required to SHETL's transmission licence in respect of 2006/07.

### **The Authority's Determination**

For the reasons set out in the May 2008 Consultation, and in accordance with paragraph 4 of Special Condition J3 – Restriction of transmission charges: Transmission Investment for Renewable Generation, the Authority determines that the term  $TIRGIncAd_t^i$  for year  $t=p+1$  (2006/07) shall take the value of £2.102 million in nominal prices, or £1.973 million in 2004/05 prices.

If you have any queries in relation to the issues raised in this letter, please feel free to contact David Hunt on 020 7901 7429 or via email at [david.hunt@ofgem.gov.uk](mailto:david.hunt@ofgem.gov.uk).

Yours faithfully,



Stuart Cook  
**Director - Transmission**  
**For and on behalf of the Authority**