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Dear Colleague

Transmission Access Review – Enhanced Transmission Investment Incentives: Approach and timetable for future work

The Transmission Owners (TOs) have identified a £5bn programme of network upgrades, following on from the 2020 Transmission study published by the Electricity Networks Strategy Group (ENSG), which they consider is likely to be needed to facilitate the achievement of the Government's 2020 targets. Ofgem is committed to ensuring that critical investments, which are needed to facilitate the achievement of the Governments's 2020 targets, are not delayed as a result of regulatory or funding considerations.

On 19 January 2010 we published the document "Transmission Access Review – Enhanced Transmission Investment Incentives: Final Proposals"[1] (our "Final Proposals"). Our work on enhanced transmission investment incentives ("TO incentives") seeks to provide a funding framework, within the current transmission price control period (TPCR4), for critical transmission investments.

Our Final Proposals document also discussed how we will phase our decisions on funding the £5bn programme of network upgrades. We explained that, based on our assessment to date, we would fund the first tranche of investment, valued at £319m[2], as part of a potential £1 billion package of extra investment in Britain's high-voltage networks by April 2012. This initial tranche includes £78m of pre-construction work across a range of projects and £241m on specific projects due to commence construction by April 2011.

Across the remaining projects, the TOs plan a further £764 million of investment up to the end of 2011/12. These projects will continue to be developed by the TOs and at a later stage, following receipt of further information, we may carry out further work to give further consideration to funding the remaining investment planned by the TOs.

[1] Transmission Access Review – Enhanced Transmission Investment Incentives: Final Proposals, available at: http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=204&refer=Networks/Trans/ElecTransPolicy/tar
[2] In 2008/09 prices

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This letter sets out our proposed approach and timetable for additional work in relation to projects requiring construction funding by the end of 2011/12.

We propose that our proposed approach and timetable for considering requests will apply to additional funding which:

- Relates to a transmission investment project previously considered in the context of our TO incentives work, and /or

- Relates to construction work (or an unfunded element of construction work) which is planned to commence by the end of 2011/12 and for which we did not reach a funding decision in our Final Proposals.

Requests of this nature are referred to as "additional funding requests" in this letter.

Approach

Assessment criteria

Our previous assessment, on which our Final Proposals were based, identified five key areas relevant to an assessment of funding needs under our TO incentives funding framework. These are: need case, scope, timing, planning consent and technical readiness. We consider that these areas remain relevant to an assessment of an additional funding request. Therefore, in reaching our decisions on such a request we will take into account the prevailing need case and the current state of TO readiness to take forward the planned work. We may also consider the appropriateness, in the interests of existing and future consumers and the achievement of sustainable development, of providing construction funding in cases where the need case is uncertain.

Where we are satisfied that there is sufficient justification for further detailed assessment for the provision of construction funding, we will also assess efficient costs and identify deliverables for the relevant activities.

We expect that in providing additional funding, we will adopt the TO incentives funding framework set out in our Final Propsoals and will follow the same approach with respect to the level of incentivisation and depreciation, unless we consider there are good reasons to differ from this approach. We noted in our Final Proposals that a different approach may be appropriate when funding projects which we consider have materially different characteristics, e.g. in terms of risk profile, than other investments funded under TPCR4. Where relevant, our assessment of an additional funding request will consider such matters.

Information requirements

In order to complete a full and fair assessment of an additional funding request we will require a minimum amount of supporting information to be provided by the TO. If we have insufficient information to be able to complete our assessment in a timely manner then we may not be in a position to reach a funding decision in the timescales set out below.

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To assist the TOs with preparing the information to be provided in support of an additional funding request, we have set out in Appendix 1 of this letter a summary of the minimum supporting information we expect to consider in our assessment. Where information is not available, or is only available in draft form at the time of making the additional funding request, we will require this information to be provided or confirmed at an appropriate stage to enable us to complete our assessment.

In addition to providing details of the current status of relevant projects, we expect the supporting information provided by the TO to highlight the key areas where there has been a change from the information submitted in the context of any previous assessment undertaken under our TO incentives work.

Where the additional funding request relates to a transmission investment project which has already received funding under the TO Incentives funding arrangement, we expect the supporting information provided by the TO to also include relevant details of current progress on the activities already funded.

Process

Following receipt of an additional funding request we will consider how to assess the information provided by the TO. We may request that the TO provides further information before we commence our assessment.

When we are satisfied that we have sufficient information to be able to commence our assessment of the additional funding request we will provide the TO with an indication of our expected process and timescales for finalising our funding proposals and, where applicable, implementing those proposals through licence changes. We will keep this timetable under review and will update the TO of any changes. We may also provide updates to and/or consult with interested parties at appropriate stage(s) in the course of completing our assessment and finalising our funding proposals.

We may commission consultants to support our assessment. Our consultants may request further information from the TO through the course of their work. We may apply a cut-off date for provision of information to be taken into account in our assessment.

We expect to publish our funding proposals incorporating details of our assessment and findings of our consultancy work. We will publish a statutory consultation under section 11 of the Electricity Act (1989) before issuing a direction on any licence changes that are required to give effect to our funding proposals.

Licence changes

If implemented[3], our Final Proposals will provide funding, up to the end of 2011/12, for pre-construction work and/or construction work on the transmission investment projects (or in some cases, specific elements of works on a given transmission investment project) identified in Annex A of the new special licence condition for each licensee.

[3] On 26 February 2010 we published an open letter[3] setting out our statutory consultation (our "statutory consultation") incorporating a Notice under Section 11(2) of the Electricity Act 1989 ("the Act") on our proposed modifications to the transmission licences of National Grid Electricity Transmission plc (NGET), SP Transmission Ltd (SPTL) and Scottish Hydro Electric Transmission Ltd (SHETL) give effect to our Final Proposals. Subject to responses to the statutory consultation and acceptance of the proposed modifications by the TOs, our intended aim is for the proposed modifications to take effect on and from 1 April 2010.

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For an additional funding request the relevant transmission project may be already listed in Annex A with provisions for pre-construction work and/or initial construction work. In this case a decision to provide construction funding using our TO incentives funding framework would require changes to the details already specified in Annex A for the relevant transmission investment project, to reflect new cost allowances with associated milestones and output measures as applicable for the activities to be funded.

Where the transmission investment project is not already specified in Annex A, it would be necessary to create a new section in Annex A with the relevant details for the activities to be funded. For example, this might apply to projects which TO had previously nominated for construction funding only.

Timescales

Following receipt of such an additional funding request with relevant supporting information we will seek to take forward our assessment and finalise our funding proposals in a timely manner.

We expect that, for an individual request from a TO, the process set out above may take approximately six months between receipt of the request and direction of licence changes. However this may vary depending on a range of factors including: the extent of any advance notice provided as to the TO's intention to submit an additional funding request; the timescales in which the TO provides the information required to complete our assessment; the level of assessment performed previously for the project; and whether we consult with interested parties in the course of completing our assessment and finalising our funding proposals, prior to the statutory consultation on the licence changes.

So that we may assess additional funding requests in an efficient manner we will aim to streamline our process so far as possible. Where we are in receipt of more than one additional request we will consider whether it is more efficient to consider these requests in parallel. We will take account of the materiality of the request(s) and the particular characteristics of the relevant transmission investment project(s) in deciding on the extent of any consultation that may be appropriate. We will also take account of interactions with the process by which NGET sets and applies the Transmission Network Use of System (TNUoS) tariffs, through which revenue allowed to the three transmission licensees is recovered from users. So far as practicable, we will aim to finalise our funding proposals in timescales which enable NGET to take them into account in setting TNUoS tariffs.

Timetable

Planned assessment window for provision of funding from April 2011

We anticipate that during 2010 we may receive a number of additional funding requests relating to transmission investment projects on which the TOs plan to commence construction by April 2012. We see merit in identifying a "window" in which we may expect to assess such requests in parallel so as to be in a position to finalise funding proposals in timescales which may provide for an additional revenue stream from 2011/12 onwards.

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Consistent with the approach adopted for our Final Proposals, in order to achieve this we would aim to publish our funding proposals in mid January 2011 (or sooner) and our statutory consultation in late February 2011 (or sooner) with a view to the licence changes taking effect from 1 April 2011. Taking into account the timescales for undertaking consultancy work and any industry consultation we deem appropriate, we expect to be able to meet these timescales for additional funding requests which are submitted by 1 August 2010. However, this will be dependent on us receiving all necessary supporting information in timescales which enable us to complete our assessments in a timely manner.

Assessment outside planned window

We note that it is for the TOs to decide when to submit an additional funding request, taking into account our information requirements and expected process and timescales as set out above. We discussed our proposal to assess requests in the planned window with the TOs, and received feedback that this would suit the majority of cases. However, we also envisage a potential requirement to assess projects outside the planned window.

For example, where an additional funding request relates to construction work to be undertaken in 2010/11, and the TO is in a position to submit an additional funding request with all supporting information significantly in advance of 1 August 2010, then we may consider it appropriate to progress the request separately with a view to providing clarity of funding sooner. Similarly, where the TO wishes to submit an additional funding request for construction work to be undertaken in 2011/12, but does not expect to be in a position to provide all necessary supporting information in the timescales necessary for assessment in the planned window, then we may consider such a request at a later stage.

Additional funding requests made outside the planned window will be dealt with in the same way as that set out above. However, we will consider, on a case by case basis, the appropriate timescales to be adopted for our assessment. We note that in such cases it may not be possible to align the provision of funding with the TNUoS charging process.

Funding arrangements for 2012/13

As noted above, our TO incentives funding framework will be used to provide initial funding up to the end of 2011/12. Funding arrangements for 2012/13 will be considered as part of our work on the one year adapted rollover of TPCR4[4] and we will set out our proposed way forward regarding a potential extension to the TO incentives funding framework in due course.

Way forward

We remain committed to ensuring that funding arrangements do not prevent the timely delivery of critical transmission investments. We would therefore underline the importance of the transmission companies approaching us in the event that investments which they regard to be critical are at risk of delay because of funding arrangements.

[4] Transmission Price Control 4 – Scope of the "Adapted Roll-over" (2012-13), available at: http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?file=TPCR4_Rollover_Scope_ConDoc_FINAL.pdf&refer=Networks/Trans/PriceControls/TPCR4%20roll-over

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It is open to the transmission companies to submit an additional funding request at any time. By setting out, in this letter, our proposed approach and timetable for dealing with such requests, and providing clarification of our information requirements and the criteria against which such requests will be assessed, we aim to ensure that our funding allowances can continue to be a key enabler of timely and efficient network investment. We have encouraged the transmission companies to make their requests for any necessary funding from us, with the relevant supporting information as identified above, at the earliest opportunity so that we can take forward our assessments and reach our funding decisions in a timely manner. We have also identified a "window" in which we expect to be able to assess additional funding requests received by 1 August 2010, through which we would seek to align the provision of additional funding from April 2011 with the process of setting 2011/12 TNUoS charges. We will also consider requests made outside this window, although may not be able to align funding with TNUoS charge-setting.

In its recent consultation on transmission access, the Department of Energy & Climate Change has emphasised the importance of timely investments by the transmission companies. We will be applying active scrutiny to the timely and complete requests for funding by the transmission companies. It may be necessary for us to take action in the event that we are not satisfied that the companies have acted in a way that minimises the risk of delays to critical investments.

If you wish to discuss any of the issues raised in this open letter please contact David Hunt (david.hunt@ofgem.gov.uk), Cheryl Mundie (cheryl.mundie@ofgem.gov.uk) or myself.

Yours sincerely

Stuart Cook,
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Appendix 1 – Information requirements for assessment of an additional funding request

We have compiled a list of information that we believe is required for a full and fair assessment of an additional funding request. We have compiled this information on the basis that the request applies to a transmission investment project previously nominated for funding consideration and relates to construction work (or an unfunded element of construction work) for which we did not reach a funding decision in our Final Proposals.

We note that such a request may relate to:

a) another component of an existing project listed in the Annex A;

b) a project that isn't listed in Annex A

Therefore, the specific information required can differ depending on circumstance, the extent of the previous assessment, and the nature of changes required to Annex A.

Information to be provided:

1. **An update document** highlighting key changes since the previous assessment, in terms of need case, scope, consents status, programme, design and/or forecast costs of planned works and confirming the scope of additional funding requested **OR**

   An overview document setting out the need case for the transmission investment project to construct; outlining the scope, consents status, programme, design and forecast costs of planned works; and confirming the scope of funding requested

2. **A project development plan**:

   i. (Updated) general description of planned scheme and user commitment (if relevant), identifying individual components of planned works and associated construction periods;

   ii. Definitions of scheme deliverables/outputs;

   iii. Any generic or project specific strategy or policy documents on the procedures to be followed for progressing major schemes through the planning & consents stage;

   iv. Current position regarding route and site selection, purchase, easements;

   v. Details of consultation already carried out with local authorities or other community representative groups/stakeholders and observations or conclusions;

   vi. Engineering details completed in the sanction period; and

   vii. Main assumptions – planning & consents.

3. **A detailed cost profile** (year-by-year) per project component split into pre-construction and construction costs.

4. **A detailed line item construction cost breakdown** for plant, land, labour (split into jobs).

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5. **Consents position** to describe the current position regarding planning applications including public enquiries and conditions attached to planning approvals where already granted.

6. **Detailed design information**

    i. Scheme layouts;
    ii. Single line diagrams for scheme and identifying connection points to existing network;
    iii. Substation/Link Terminal SLDs;
    iv. Main plant parameters – quantity and rating details;
    v. Route Surveys (where relevant);
    vi. Maps showing line routes, substation locations and system boundaries;
    vii. Environmental Survey Summaries (where relevant); and
    viii. Main Assumptions – design & construction.

7. **A construction programme** in form of a Gantt chart detailing the current agreed programme for all components of works. The chart should include high level/key date programmes for the preliminaries and the construction periods for each project showing main activities comprising:

    i. When a planning application was, or is, to be made,
    ii. When the planning approval was granted, or is anticipated,
    iii. Site and route acquisition actual or target dates,
    iv. When the scheme should be 'cleared to construct',
    v. Anticipated contract award dates and/or plant ordering dates, manufacturing and delivery periods,
    vi. Network access windows,
    vii. Construction key dates, and
    viii. Target construction completion date.
    ix. More detailed nested programmes should be provided where available.

8. **Key milestones** in the construction period for components requesting funding in addition to a description of progress made towards key milestones defined for existing projects.

9. **Forecast output measures** to detail what is planned to be provided at the end of construction in addition to a description of progress made in achieving forecast output measures for existing funded subcomponents of projects.

10. **Any other information** that the TO thinks that Ofgem and its consultants should consider in the assessment process.

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