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# RIIO-T1: Final Proposals for SP Transmission Ltd and Scottish Hydro Electric Transmission Ltd

## Final decision – Overview document

<b>Reference:</b>	58/12
<b>Publication date:</b>	23 April 2012

<b>Contact:</b>	Grant McEachran
<b>Team:</b>	RIIO-T1
<b>Tel:</b>	0141 331 6008
<b>Email:</b>	<a href="mailto:grant.meachran@ofgem.gov.uk">grant.meachran@ofgem.gov.uk</a>

### Overview:

This document sets out our Final Proposals for the transmission price controls for SP Transmission Ltd (SPTL) and Scottish Hydro Electric Transmission Ltd (SHETL) from 1 April 2013 to 31 March 2021.

This will be the first transmission price control to reflect the new RIIO (Revenue = Incentives + Innovation + Outputs) model. Under RIIO we are adopting a very different process for setting price controls. Companies are required to develop and submit well-justified business plans, supported by the views of stakeholders, setting out what they will deliver. Companies that submit high-quality plans will be offered the option of settling price controls early – “fast-tracking”.

Following our assessment of their business plans and in light of responses to our consultation on Initial Proposals we consider that the plans of SPTL and SHETL are suitable for fast-tracking. SPTL’s and SHETL’s business plans form the basis of these Final Proposals.

## Associated documents

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### Supporting Documents

RIIO-T1: Final Proposals for SP Transmission Ltd and Scottish Hydro Electric  
Transmission Ltd – Supporting Document

<http://www.ofgem.gov.uk/Networks/Trans/PriceControls/RIIO-T1/ConRes/Documents1/SPTSHETLFPsupport.pdf>

### Initial Proposals

RIIO-T1: Initial Proposals for SP Transmission Ltd and Scottish Hydro Electric  
Transmission Ltd

[http://www.ofgem.gov.uk/Networks/Trans/PriceControls/RIIO-T1/ConRes/Documents1/SPT\\_SHETL\\_IP.pdf](http://www.ofgem.gov.uk/Networks/Trans/PriceControls/RIIO-T1/ConRes/Documents1/SPT_SHETL_IP.pdf)

RIIO-T1: Initial Proposals for SP Transmission Ltd and Scottish Hydro Electric  
Transmission Ltd - Supporting Document

[http://www.ofgem.gov.uk/Networks/Trans/PriceControls/RIIO-T1/ConRes/Documents1/SPT\\_SHETL\\_support\\_IP.pdf](http://www.ofgem.gov.uk/Networks/Trans/PriceControls/RIIO-T1/ConRes/Documents1/SPT_SHETL_support_IP.pdf)

RIIO-T1: Initial Proposals for SPTL and SHETL for the next transmission price control  
– Impact Assessment

[http://www.ofgem.gov.uk/Networks/Trans/PriceControls/RIIO-T1/ConRes/Documents1/SPT\\_SHETL\\_IA.pdf](http://www.ofgem.gov.uk/Networks/Trans/PriceControls/RIIO-T1/ConRes/Documents1/SPT_SHETL_IA.pdf)

### Other Relevant Documents

RIIO-T1 – Implementing competition in onshore electricity transmission

<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=150&refer=Networks/Trans/PriceControls/RIIO-T1/ConRes>

RIIO-T1: Decision on fast-tracking for SPTL and SHETL

<http://www.ofgem.gov.uk/Networks/Trans/PriceControls/RIIO-T1/ConRes/Documents1/Further%20assessment%20of%20RIIO-T1%20business%20plans.pdf>

Decision on strategy for the next transmission price control - Overview paper

<http://www.ofgem.gov.uk/Networks/Trans/PriceControls/RIIO-T1/ConRes/Documents1/T1decision.pdf>

Handbook for implementing the RIIO model - Ofgem, October 2010

<http://www.ofgem.gov.uk/Networks/rpix20/ConsultDocs/Documents1/RIIO%20handbook.pdf>

Glossary

<http://www.ofgem.gov.uk/Networks/GasDistr/RIIO-GD1/ConRes/Documents1/Glossary.pdf>

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# Executive Summary

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Britain's gas and electricity network companies face unprecedented challenges. They will need to invest over £30 billion over the next decade to develop smarter networks, to meet environmental challenges and to secure energy supplies. Against this backdrop, it is more important than ever that network companies can show consumers they are getting value for money.

This is the first price control to be conducted under our new RIIO model (Revenue = Incentives + Innovation + Outputs). Through RIIO-T1, we are setting the regulatory framework to apply to electricity and gas transmission companies from 1 April 2013 to 31 March 2021. The objective of RIIO is to encourage network companies to play a full role in the delivery of a sustainable energy sector, and to do so in a way that delivers value for money for existing and future consumers.

A key part of the RIIO model is our intention to focus greater attention on the areas of the controls where such greater attention is warranted. In other words, we set out our intention to adopt a proportionate approach to our assessment of the companies' business plans. This approach provides strong financial and reputational incentives on network companies to step up to the challenge of providing well thought out and well-justified business plans. Companies that submit high quality plans will be able to agree price controls early, ie achieve "fast-tracking".


In October 2011 we took the decision to retain SP Transmission Ltd (SPTL) and Scottish Hydro Electric Transmission Ltd (SHETL) in the RIIO-T1 fast-track process and, reflecting further progress in the intervening period, in February 2012 we published Initial Proposals for those companies for the RIIO-T1 period.

In the Initial Proposals we noted that there were a number of areas where we expected SPTL and SHETL to undertake further work. These were in relation to their approach for delivering improved environmental performance and in relation to ongoing workstreams for their network availability and customer satisfaction outputs. We note that both SPTL and SHETL have provided additional information and demonstrated significant progress in relation to these areas. As a result, both companies have either already resolved, or provided us the confidence that they will be able to resolve, the outstanding issues we identified in the Initial Proposals in time for the start of RIIO-T1.

In addition, we received a significant response from stakeholders to the Initial Proposals. For the most part responses were very supportive of both the proposals to fast-track the plans of both SPTL and SHETL and the basis of those proposals.

In light of positive respondents' views and the additional progress made by the companies in relation to outstanding areas of work we consider we are in a position to put forward Final Proposals for both SPTL and SHETL. These Final Proposals provide for:

- a comprehensive set of outputs that reflect the interests of their customers and strong incentives to deliver those outputs over the RIIO-T1 period
- a package of measures to encourage SPTL and SHETL to innovate to drive improved outcomes for consumers
- upfront funding for around £2.3bn of investment in the Scottish transmission network with scope for an additional £3.7bn to be brought forward for



## RIIO-T1: Final Proposals for SP Transmission Ltd and Scottish Hydro Electric Transmission Ltd

investment during the RIIO-T1 period – this gives total investment of around £6bn in 2009/10 prices (or £7.6bn after inflation)

- a package of mechanisms for addressing risk and uncertainty over the 8 year period of the price control
- a financial package which provides an appropriate level of financial reward to the companies for their activities and also provides value for money to consumers.

These Final Proposals are different from previous price controls as they reflect the basis of the business plans put forward by the companies for RIIO-T1. As a result, the packages are tailored for each company and differ from each other in a number of respects.

We note that setting these Final Proposals does not mean the end of the process for either SPTL or SHETL. We expect both companies to continue to work constructively to finalise all aspects of their outputs to enable them to deliver effectively from the start of RIIO-T1. We also expect both companies to continue to engage with their stakeholders and to continue to strive to improve their processes for engagement both before and throughout the RIIO-T1 period.

This document does not set out Final Proposals for National Grid Electricity Transmission plc (NGET) or National Grid Gas Transmission plc (NGG). We intend to publish, for consultation, our Initial Proposals for NGET and NGG in July 2012.

# 1. Introduction

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## Chapter Summary

This chapter explains the structure and purpose of this document and sets out the context of these Final Proposals.

## Purpose of this document

1.1. This document sets out our “fast-track” Final Proposals for SP Transmission Ltd (SPTL) and Scottish Hydro Electric Transmission Ltd (SHETL) for the next transmission price control, RIIO-T1. SPTL and SHETL own and maintain the transmission network assets in Scotland. This price control will cover the eight-year period from 1 April 2013 to 31 March 2021.

1.2. This document aims to provide an accessible overview of the Final Proposals for SPTL and SHETL. Alongside this document we have published a Supporting Document.<sup>1</sup> The Supporting Document is aimed primarily at network companies, investors and those who require a more in-depth understanding of the proposals. The Supporting Document is divided into the key areas of the price control packages to allow the reader to dip into the parts of most interest to them.

1.3. These Final Proposals are different from those we have set out in previous price control processes. This is for two reasons.

- (1) At an early stage in the RIIO process we consulted, and then published decisions, on the regulatory framework for RIIO-T1 – our Strategy Decision document<sup>2</sup> (“Strategy Decision document”). That document set out the regulatory framework for the RIIO-T1 price control.
- (2) We are putting forward the business plans of SPTL and SHETL for “fast-tracking”. Fast-tracking means finalising the price controls of a company at an early stage in the process on the basis that we consider its proposals are well-justified and in the interests of consumers. These Final Proposals are therefore based directly on the updated RIIO-T1 business plans developed by SPTL and SHETL. These plans are available at the following links:

- SPTL: [http://www.spenergynetworks.co.uk/publicinformation/stakeholder\\_riio.asp](http://www.spenergynetworks.co.uk/publicinformation/stakeholder_riio.asp)
- SHETL: <http://www.ssepd.co.uk/Projects/TransmissionPriceControlReview/>

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<sup>1</sup> RIIO-T1: Final Proposals for SPTL and SHETL - Supporting Document  
<http://www.ofgem.gov.uk/Networks/Trans/PriceControls/RIIO-T1/ConRes/Documents1/SPTSHETLFPsupport.pdf>

<sup>2</sup> Decision on strategy for the next transmission price control - RIIO-T1  
<http://www.ofgem.gov.uk/Networks/Trans/PriceControls/RIIO-T1/ConRes/Documents1/T1decision.pdf>

1.4. This document sets out a summary of respondents' views to our February Initial Proposals consultation and highlights the changes to the proposals we are making in light of these views. We provide high-level summaries of responses in the specific sections of Chapters 2-6 in the Supporting Document and a more detailed summary in Appendix 1 of this document.

1.5. In our Initial Proposals we highlighted a number of specific areas where both SPTL and SHETL were required to undertake further work to inform our Final Proposals. These all related to components of the outputs framework. We provide an update on these areas and their implications for Final Proposals in Chapter 2 of the Supporting Document.

1.6. This document does not set out Final Proposals for National Grid Electricity Transmission plc (NGET) or National Grid Gas Transmission plc (NGG). We are taking forward the controls for NGET and NGG under the non-fast-tracking process. Both submitted updated business plans on 2 March 2012. We intend to publish, for consultation, our Initial Proposals for NGET and NGG in July 2012.

## RIIO

1.7. In October 2010<sup>3</sup>, we announced a change in the way we will regulate the GB onshore network companies. We introduced the RIIO (Revenue = Incentives + Innovation + Outputs) model. The overriding objective of the RIIO model is to drive real benefits for consumers by providing energy network companies with strong incentives to meet the challenges of delivering a low carbon economy and a sustainable energy sector at a lower cost than would have been the case under the previous approach.

1.8. The price control process under RIIO is different to previous controls. In particular, under RIIO the onus is on network companies to develop well-justified business plans. Each network company is required to develop detailed plans which demonstrate how they will deliver in the interests of both existing and future consumers and how they will meet the challenges associated with facilitating the move to a low carbon economy. Companies which rise to this challenge may benefit from proportionate treatment and potentially "fast-tracking". Proportionate treatment provides benefits in terms of enabling us to focus our resources to deliver most value for consumers.

1.9. Fast-tracking provides strong incentives for the companies. Fast-tracking means that a company, by receiving its Final Proposals approximately a year ahead of the implementation of its control, will be able to get on with business as usual without focusing as much resource on the price control process. It also means a company will be a significant driver of its final price control package. We will aim to ensure that a company who is fast-tracked does not secure a settlement that means it is worse off than if it had remained in the price control process.

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<sup>3</sup> RIIO - A new way to regulate energy networks: Final Decision – October 2010  
<http://www.ofgem.gov.uk/Networks/rpix20/ConsultDocs/Documents1/Decision%20doc.pdf>



1.10. We published a timetable for RIIO-T1 in our Strategy Decision document. An updated timetable for the review is set out in Appendix 2.

## Role of this document in the RIIO-T1 process

1.11. Our Strategy Decision document set out the key elements of the regulatory framework that the transmission owners (TOs) would need to understand in order to develop their business plans. We received the TOs' RIIO-T1 business plans at the end of July 2011. We assessed those plans against the criteria that we had set out in our Strategy Decision document.

1.12. In October we published our initial assessment of the RIIO-T1 business plans.<sup>4</sup> Our initial assessment concluded that none of the plans were suitable for fast-tracking in their existing format but that the scale of the outstanding issues for SPTL and SHETL might allow them to resolve these in a timeframe consistent with fast-tracking. On this basis we retained SPTL and SHETL in the fast-tracking process. Our assessment outlined the issues SPTL and SHETL would need to address in order for us to develop Initial Proposals in early 2012.

1.13. In late December both companies submitted updated plans in which they sought to address outstanding issues. We assessed these plans using the same criteria we used to assess the original plans. On 23 January we published our decision<sup>5</sup> that the business plans of SPTL and SHETL were of sufficient quality to be consulted upon through fast-tracking Initial Proposals with a view to potentially reaching early settlement of their price controls, ie that their business plans are suitable for fast-tracking. In February we published Initial Proposals<sup>6</sup> for both SPTL and SHETL and sought respondents' views on the suitability of that package of proposals for fast-tracking.

1.14. The purpose of this document is to set out the basis of the Final Proposals for SPTL and SHETL. The document sets out: what these network companies will be required to deliver during the next price control period; the incentives that will be placed around that delivery; the costs the companies will be able to recover and the arrangements for addressing risk and uncertainty around those costs; and the basis of the financial package for determining the companies' allowed revenues.

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<sup>4</sup> Initial assessment of RIIO-T1 business plans and proportionate treatment – October 2011

<http://www.ofgem.gov.uk/Networks/Trans/PriceControls/RIIO-T1/ConRes/Documents1/busplanletter.pdf>

<sup>5</sup> RIIO-T1: Decision on fast-tracking for SP Transmission Ltd and Scottish Hydro Electric Transmission Ltd

<http://www.ofgem.gov.uk/Networks/Trans/PriceControls/RIIO-T1/ConRes/Documents1/Further%20assessment%20of%20RIIO-T1%20business%20plans.pdf>

<sup>6</sup> RIIO-T1: Initial Proposals for SP Transmission Ltd and Scottish Hydro Electric Transmission Ltd

[http://www.ofgem.gov.uk/Networks/Trans/PriceControls/RIIO-T1/ConRes/Documents1/SPT\\_SHETL\\_IP.pdf](http://www.ofgem.gov.uk/Networks/Trans/PriceControls/RIIO-T1/ConRes/Documents1/SPT_SHETL_IP.pdf)

## Stakeholder engagement

1.15. The RIIO framework places considerable emphasis on stakeholder engagement, both by the network companies and by Ofgem. The requirement on TOs to undertake detailed stakeholder engagement and to demonstrate how this has been reflected in their plans is a key component of the RIIO process.

1.16. Since the start of RIIO-T1, we have adopted a multi-layered process to ensure that all affected parties have effective opportunities to engage in the review. When we have engaged with stakeholders, we have sought to adhere to our principles for effective enhanced engagement set out in the RIIO handbook.

1.17. The key elements of our recent process have been the consultation on our Initial Proposals and a range of bilateral meetings with SPTL and SHETL as well as with other interested stakeholders.

1.18. We will continue to engage with all interested parties throughout the RIIO-T1 process.

### Consumer Challenge Group (CCG)

1.19. Separate from our stakeholder engagement processes, we have benefited from feedback from the CCG, which comprises consumer and environmental experts acting as a critical friend to Ofgem.

1.20. The CCG has an important role in ensuring that consumers' views are fully considered as part of the price control process. We have formed a single CCG for RIIO-T1 and the concurrent gas distribution price control review (RIIO-GD1). The group comprises eight members appointed by us on the basis of their expertise in the interests of existing and future consumers and energy sector knowledge.

1.21. We met with the CCG in January and set out their key messages in our Initial Proposals. In summary the key points raised by the CCG were:

- Any changes made to SPTL's and SHETL's plans should be justified through a thorough consideration of options in conjunction with stakeholders.
- It was important that the companies recognised the areas that required further development and committed to strengthening their approaches in these areas going forward.
- The companies' updated plans should be clear and highlight areas of change backed by justification along with areas of weakness and strategies for continued improvement.

## Impact assessment

1.22. In February, alongside the Initial Proposals, we also published an impact assessment (IA). We did not receive any specific comments on the IA. We consider that the benefits and impacts outlined in the IA are still applicable to the updated proposals outlined in this document. We intend to publish an IA with the Initial Proposals for NGET and NGG.

## Interaction with other policy areas

### SO incentives

1.23. In parallel with our work on RIIO-T1, we are working to set system operator (SO) external incentives<sup>7</sup> for the period from 1 April 2013. We are working with the electricity SO to finalise, for each output and cost incentive scheme, some of the scheme parameters including the appropriate scheme length. One of our objectives across the two workstreams is to align the incentives facing the SO and TOs to encourage effective joint working. One of the areas where this will bring benefits is in relation to network availability, which is relevant to the RIIO-T1 outputs. We consider this issue in more detail in Chapter 2 of the Supporting Document.

### Broad environmental incentive

1.24. In our Strategy Decision document we noted our intention to include a reputational incentive on promoting low carbon energy flows. We further noted that, subject to consultation, we may introduce an incentivised financial reward which would future proof the output framework for new opportunities arising during RIIO-T1.

1.25. On 7 February 2012 we published a consultation on the introduction of an environmental discretionary reward (EDR)<sup>8</sup> to complement the existing RIIO-T1 package for electricity transmission. Under the EDR the companies' performance will be measured and scored on an environmental balanced score card comprising six key strategic and operational environmental issues. In addition the companies will be required to publish and consult on an annual executive level planning statement. We have proposed to establish a panel of experts to consider each TO's score from the process, who would then recommend the level of any reward made. An annual reward of up to a maximum of £4 million (up to £32m over RIIO-T1) across all of the electricity TOs would be available. The purpose of an EDR is to sharpen companies' focus on strategic environmental considerations and encourage corporate and operational culture change to facilitate a growth in low carbon energy.

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<sup>7</sup> The electricity SO has responsibility for day-to-day system operation, including balancing of the system and constraint management, of the electricity transmission network. National Grid Electricity Transmission plc (NGET) is the electricity SO.

<sup>8</sup> Environmental discretionary reward under the RIIO-T1 price control – 7 February 2012  
[http://www.ofgem.gov.uk/NETWORKS/TRANS/PRICECONTROLS/RIIO-T1/CONRES/Documents1/EDR\\_consult.pdf](http://www.ofgem.gov.uk/NETWORKS/TRANS/PRICECONTROLS/RIIO-T1/CONRES/Documents1/EDR_consult.pdf)

1.26. We received seven responses to our consultation on the EDR. We will publish our Final Proposals in this area shortly.

### **Transmission Investment Incentives**

1.27. We introduced Transmission Investment Incentives (TII) in 2009 to supplement capital allowances and revenue drivers set within TPCR4 to facilitate the timely delivery of critical electricity transmission infrastructure projects. These arrangements will continue for the rollover year 2012/13.

1.28. For RIIO-T1 we are introducing arrangements to enable TOs to request Ofgem to determine the efficient forecast costs of delivering wider works outputs and to adjust the TOs' wider works outputs and associated revenues during the price control period (ie within period determination). These arrangements will replace the TII arrangements introduced during TPCR4.

### **Innovation**

1.29. A core part of the RIIO framework is introducing an innovation stimulus. The innovation stimulus will comprise:

- **Network Innovation Allowance (NIA)** - The NIA is a set allowance that each of the RIIO network licensees will receive to fund small-scale innovative projects as part of their price control settlement.
- **Network Innovation Competition (NIC)** - The NIC is an annual competition for funding larger more complex projects which have the potential to deliver low carbon and/or wider environmental benefits to consumers. The NIC will comprise of two competitions - one for gas and one for electricity. There will be up to £20m of funding available for each year of the gas competition and up to £30m of funding for each year of the electricity competition.
- **Innovation Roll-out Mechanism (IRM)** - A Revenue Adjustment Mechanism that enables companies to apply for additional funding within the price control period for the rollout of initiatives with demonstrable and cost effective low-carbon or environmental benefits.

1.30. In order to implement the innovation stimulus we will develop licence conditions, which will allow companies to raise the funding and set the legal framework for the governance arrangements. The governance arrangements will provide detailed assessment criteria, guidance on obligations and requirements for the NIC, as well as criteria and obligations attached to the utilisation of the NIA.

1.31. In general, the innovation stimulus will be introduced as part of the RIIO-T1 and GD1 price controls on 1 April 2013. The exception may be the Gas NIC. We recently announced that we have identified a barrier to delivering our proposed funding approach for the NIC in the Gas sector. We are actively working with DECC to resolve this issue at the earliest opportunity. However, currently it appears

unlikely that the first Gas NIC will be able commence in April 2013, as previously planned.<sup>9</sup>

1.32. We are continuing our work to develop a set of governance arrangements which can be applied consistently in running both the Gas and Electricity NICs. An innovation working group has been established to support this process. The governance arrangements will be defined in a governance document for each sector and these will be consulted on in October 2012, as part of the second informal licence consultation.

### **Implementing competition in onshore electricity transmission**

1.33. As part of the RIIO strategy, we have been developing a framework to enable Ofgem to hold, in appropriate circumstances, a competitive process to award a TO the revenue stream needed to build, own and operate onshore electricity transmission assets. We set out our initial thoughts on aspects of this framework in consultations published in March and most recently in December 2011.<sup>10</sup> We are continuing to develop the framework and our open letter published today<sup>11</sup> provides an update on our plans.

1.34. It is our intention that this competitive framework could potentially be used to award the revenue stream for any wider reinforcement works for which construction funding has not been awarded to date and is not contained in the licensees' RIIO-T1 baseline funding. For the avoidance of doubt, projects treated as Strategic Wider Works (SWW) in our RIIO Final Proposals could be subject to this competitive process and therefore potentially delivered by a third party TO.<sup>12</sup> While the detailed arrangements for the competitive process are still being developed, TOs should be aware that they could be required to make relevant pre-construction outputs available to third parties as part of a selection process, and eventually such assets might be transferrable to the party selected to construct the assets.

### **Charging volatility**

1.35. We have recently published a consultation<sup>13</sup> on options to mitigate network charging volatility arising from the price control settlement. We are consulting on five options that could be implemented to help mitigate volatility and the consultation includes our initial assessment of implementation of each option. We will publish our final decision in the summer. We will consider at this time the impact of our decision

<sup>9</sup> More information about the potential delay to the Gas NIC can be found at the link below (p 16)  
<http://www.ofgem.gov.uk/Networks/nic/Documents1/March%20decision%20document%20Final.pdf>

<sup>10</sup> RIIO-T1 – Implementing competition in onshore electricity transmission  
<http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=150&refer=Networks/Trans/PriceControls/RIIO-T1/ConRes>

<sup>11</sup> RIIO-T1: Implementing competition in onshore electricity transmission - update  
<http://www.ofgem.gov.uk/Networks/Trans/PriceControls/RIIO-T1/ConRes/Documents1/Compupdate.pdf>

<sup>12</sup> A third party TO may be one of the existing TOs or a new TO.

<sup>13</sup> Mitigating network charging volatility arising from the price control settlement  
[http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?file=Charging\\_Volatility\\_Cons.pdf&refer=Networks/Policy](http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?file=Charging_Volatility_Cons.pdf&refer=Networks/Policy)

on the fast-tracked TOs. However, the changes associated with the options outlined will have a limited impact on the final settlement and therefore will not impact the basis of the Final Proposals outlined in this document.

## Structure of this document

1.36. The remainder of this document sets out the Final Proposals for SPTL and SHETL. This document follows broadly the same structure as the Initial Proposals. It is structured as follows:

- Chapter 2 sets out a high-level overview of the key points raised by respondents' on the Initial Proposals.
- Chapter 3 sets out a summary of the package of Final Proposals for SPTL.
- Chapter 4 sets out a summary of the package of Final Proposals for SHETL.
- Chapter 5 sets out next steps for RIIO-T1.

1.37. Appendix 1 sets out a more detailed summary of respondents' views.

1.38. Alongside this document we have published a Supporting Document. This provides further information on each of the individual areas of the Final Proposals for SPTL and SHETL.

## 2. Overview of responses

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### Chapter Summary

This chapter provides a high level overview of the key issues raised by respondents to the Initial Proposals.

### Introduction

2.1. We received 19 responses to the Initial Proposals consultation. This included responses from SPTL and SHETL. Two responses were marked as confidential.

2.2. The purpose of this chapter is to set out an overview of the key points raised by respondents in relation to the overall process. The more detailed comments in relation to the different component parts of the framework ie outputs, innovation, cost assessment, financial issues and uncertainty, are summarised in the relevant chapters of the Supporting Document.

2.3. A full summary of responses is set out in Appendix 1.

### Overall view on fast-tracking SPTL and SHETL

2.4. The main question we asked respondents was whether they considered each of the companies were suitable for fast-tracking.

#### *Respondents' views*

2.5. Nearly all third parties supported the suitability of the SPTL and SHETL plans, as set out in the Initial Proposals, for fast-tracking. Six respondents noted that the companies' business plans set out a clear strategy to respond to the need for major investment in system reinforcement to support the low carbon economy and security of supply.

2.6. A number of respondents highlighted other benefits that would be provided by the plans. One respondent noted that the implementation of the plans would contribute to new jobs and upskilling the existing workforce in Scotland. Another respondent noted its support for SHETL's plans to invest in its network in an environmentally sensitive manner to minimise the impact on Scotland's natural environment.

2.7. One respondent said it found it difficult to assess the companies' business plans because there were a number of related initiatives, such as SO incentives and details of the RIIO-T1 package itself that were yet to be resolved. Accordingly, it

considered it was too early to say whether the Initial Proposals struck the right balance of risk and affordability for consumers.

#### *Our views*

2.8. We welcome the strong level of support for fast-tracking the plans of the Scottish TOs. We note that more respondents commented in support of SHETL's suitability for fast-tracking. However, all respondents that commented on the case for SPTL's plan being fast-tracked were also supportive.

2.9. We note the comment in relation to the difficulty of assessing the package given specific details remain outstanding. We recognise that some details of the RIIO package notably in relation to the network availability and customer satisfaction outputs remain incomplete. However, the basis of the required outputs and the strength of the associated incentives are finalised in both these areas. It is these elements that are central to understanding the balance of risk in the package. We further recognise that there are other outstanding initiatives, for example SO incentives, that will be relevant to the overall impact. These are not part of RIIO and will be determined through a separate process.

#### **Stakeholder engagement**

2.10. The requirement to undertake detailed stakeholder engagement and to demonstrate how this has been reflected in the companies' plans is a key component of the RIIO process. A number of respondents commented on their experience of engagement with SPTL and SHETL in RIIO-T1.

#### *Respondents' views*

2.11. Most stakeholders were very enthusiastic about the companies' engagement processes in developing their business plans. In particular, seven civil engineering and equipment service providers said that the transparency of SHETL's business plans allowed them to plan their recruitment and training needs, identify innovative solutions to challenges and to adopt a competitive price strategy which would result in cost efficiencies for SHETL.

2.12. Three respondents noted that they looked forward to ongoing stakeholder engagement with the companies throughout the implementation of the RIIO-T1 business plans.

2.13. Both SPTL and SHETL stressed the importance of ongoing stakeholder engagement. SHETL set out a plan to consult in July on an ongoing strategy for engagement and on a number of other outstanding areas.



*Our views*

2.14. We consider that both SPTL and SHETL have made significant progress in this area. We welcome the views of respondents which confirm this view. We expect the companies to keep developing their approaches and to seek continually to improve throughout RIIO-T1. We will continue to monitor the companies' progress in this area.

**Process going forward**

2.15. Both SPTL and SHETL raised comments on the process following the fast-track decision.

*Respondents' views*

2.16. SPTL and SHETL welcomed the recommendation to fast-track their plans. Both raised similar points regarding the process going forward, namely:

- licence drafting should be finalised as soon as possible to provide greater certainty and this should be accompanied by the Financial Handbook
- to ensure no policy changes are introduced at a later stage, decisions relating to the RIIO-T1 price control should be set out in the Final Proposals, Financial Handbook and/or licence conditions.

2.17. In addition SHETL noted that:

- work on all related areas – SO incentives, Environmental Discretionary Reward, Competition in Electricity Transmission, Charging Volatility, Regulatory Ring Fencing and changes to Compliance arrangements – should be progressed as separate policy areas rather than as part of RIIO. It considered that if this were not the case fast-tracked parties could be disadvantaged by the development of policy between their submissions and the commencement of the price control
- in so far as practical, obligations on the companies should be set out in the licence conditions rather than in secondary documents.

*Our views*

2.18. As RIIO-T1 is the first time we are fast-tracking any companies' price controls we recognise that the associated process is new.

2.19. We agree on the need to finalise licence drafting as early as possible. It is for this reason that we initiated the licence drafting working group meetings at an earlier stage in the process than in any previous price control. However, given the scope of the task involved we need to develop a robust set of licence conditions before we can consult on them. We intend to hold an initial consultation on the first full set of

licence conditions for both fast-tracked and non-fast-tracked companies in July 2012. We intend to publish the first draft of the Financial Handbook at the same stage.

2.20. We note the view that obligations on the companies should be reflected directly in licence conditions rather than in secondary documents. In RIIO, as in setting previous price controls, there are a number of areas where we consider the details on how specific arrangements will work are better reflected in supporting documents. This is because there is a significant level of detail in some areas and to put this on the face of the licence would reduce the accessibility of that document. Having said that, we do agree with the respondent that where practicable key obligations should be contained in the licence conditions.

2.21. Although we will be consulting on the licence conditions three months after publishing fast-track Final Proposals, policy will be as set out in these Final Proposals. We do not intend to introduce new policy areas outside of this process. Therefore, although there are a number of policy areas including SO incentives, Competition in Transmission, Regulatory Ring-Fencing which will bring forward policy that will interact with the RIIO policy, these remain separate from RIIO and policy in these areas will be finalised separately albeit in some cases alongside the RIIO process.

## 3. Summary of Final Proposals for SPTL

### Chapter Summary

This chapter summarises the Final Proposals for SPTL.

### Introduction

3.1. This chapter summarises the key components of SPTL's Final Proposals. Further detail on each of the areas set out below is provided in Chapters 2-6 of the Supporting Document.

### Outputs and incentives

3.2. RIIO is an outputs-led framework. It is important that throughout the RIIO-T1 period, the TOs understand what they are expected to deliver and are held to account for delivery.

3.3. Table 1 summarises the outputs that SPTL has stated that it will deliver, and will be required to deliver, during RIIO-T1. It also outlines the associated incentives where applicable.

**Table 1 – SPTL's outputs and incentive parameters for RIIO-T1**

Output	Incentive
Safety	Compliance with safety obligations set out by Health and Safety Executive (HSE). No financial incentive.
Reliability	Primary output based on Energy Not Supplied (ENS) with a 3% collar on financial penalties and a licence condition on minimum performance standard.
Availability	Prepare and maintain a Network Availability Policy <sup>14</sup> . No financial incentive.
Customer Satisfaction	Develop a customer satisfaction survey that will be subject to an incentive +/-1% of allowed revenue.
Connections	Requirement to meet existing legal requirements with a downside penalty of 0.5% of allowed revenue for failure to meet its timing requirements.
Environmental	This will comprise the following components: <ul style="list-style-type: none"> <li>SF<sub>6</sub> – Baseline set consistent with best practice. Differences to baseline will be subject to a reward/penalty based on the non-traded carbon price for carbon equivalent emissions.</li> <li>Losses – Baseline set for the expected impact of its proposed investment on modelled losses and requirement to report annually on contribution to reduced losses. SPTL will publish</li> </ul>

<sup>14</sup> We also note that, reflecting the coverage of the document, all parties have agreed that the policy should now more accurately be referred to as the Network Access Policy.

	<p>its initial report in June.</p> <ul style="list-style-type: none"> <li>• Business Carbon Footprint (BCF) – BCF baseline for RIIO-T1. Commitment to develop business level reporting system and to review carbon reduction opportunities and control strategies during RIIO-T1.</li> <li>• Visual amenity – Requirement to demonstrate an ongoing commitment to a range of mitigation measures. Allowance available to reduce the impact of existing infrastructure.</li> <li>• EDR – Additional measures to focus on aspects of the roles of the transmission companies which may not be explicitly captured in the proposed RIIO-T1 incentives. We will finalise details separately.</li> </ul>
Wider works <sup>15</sup>	<p>Baseline wider works outputs of 3,300MW of additional network transfer capacity. To use SWW arrangements for additional SWW outputs (this could include outputs up to 1,100MW of new transmission capacity on the main integrated transmission system over and above the baseline).</p> <p>Materiality criteria of £100m for initiating such requests. All SPTL's wider works outputs will be subject to timely delivery standards.</p>

3.4. There are a number of areas where SPTL was required to and has subsequently undertaken further work on its outputs since the publication of its Initial Proposals. The main developments are as follows:

- Availability – SPTL along with SHETL and NGET has been very productive in progressing work in this area and have met on numerous occasions since the publication of the Initial Proposals. While there are still issues to resolve, significant progress has been made in developing aspects of the proposals. In particular, significant progress has been made in relation to the issues of transparency and the sharing of information which will be an important element of the new arrangements.
- Customer satisfaction – SPTL has set out how they are continuing to progress work in this area alongside SHETL and NGET. SPTL has provided more detail on its plans for developing its survey and noted its intention to complete and agree a survey pro-forma with a view to implementing a survey from the start of the price control period.
- Environmental outputs – SPTL was required to provide further information in relation to its losses and its BCF. The additional information it has provided is as follows:
  - SPTL has confirmed its intention to report publicly on an annual basis about what they are doing to contribute to fewer losses. They will publish the first report in June this year.

<sup>15</sup> We are currently developing a framework to enable competition in electricity transmission. For the avoidance of doubt, projects treated as strategic wider works in RIIO FPs could be subject to that competitive process and therefore potentially delivered by a third party TO.

- SPTL has confirmed its intention to develop a business level reporting system for BCF and to identify further carbon reduction opportunities during the RIIO-T1 period.

3.5. We note the progress SPTL has made in each of these areas. We consider this progress is consistent with the outstanding requirements placed on SPTL. However, we note there is still work to be undertaken and the onus is on SPTL to ensure this work is completed in sufficient time to enable the new arrangements to come into place for the start of RIIO-T1. We will continue to monitor progress in these areas both up to 1 April 2013 and beyond to ensure that the arrangements meet the RIIO objectives of providing a network that delivers real value for consumers and facilitates a low carbon economy and a sustainable energy sector.

### **Innovation**

3.6. In its business plan SPTL set out a consideration of innovation through its plan as well as providing a specific innovation strategy. SPTL requested an annual Network Innovation Allowance (NIA) of 0.75% of allowed revenue.

3.7. In the Initial Proposals we noted that we did not consider that SPTL provided sufficient justification for its requested NIA. We noted that we intend to provide SPTL an allowance of 0.5% as being consistent with the default position set out in our Strategy Decision document. However, we noted that we would consider any evidence provided for a higher allowance in developing Final Proposals.

3.8. SPTL stated that while it was disappointed with Ofgem's Initial Proposal in relation to Innovation, it did not intend to put forward further information to support an NIA of higher than 0.5%. SPTL considered its efforts would be best focussed on mobilising innovation projects.

3.9. On this basis, we will provide SPTL a NIA of 0.5% of allowed revenue for RIIO-T1.

### **Cost efficiency**

3.10. There are various costs that SPTL incurs as a TO and for which it seeks to recover revenue in its price control. Table 2 sets out the costs we propose to provide through Final Proposals to deliver SPTL's business plan. These are broadly identical to the Initial Proposals with the exception that £25m of load-related capex relating to real price effects has been moved from the baseline into uncertainty mechanisms. Further detail is set out in Chapter 4 of the Supporting Document.

**Table 2 – Key cost parameters for SPTL**

Parameter	RIIO-T1 Total
	SPTL's Best view <sup>16</sup> (2009/10 prices)
Load-related capex (baseline)	£0.8bn
Load-related capex (subject to uncertainty mechanisms)	£0.5bn
Non-load related capex	£0.7bn
<b>Total capex</b>	<b>£2.0bn</b>
<b>Total controllable opex</b>	<b>£0.2bn</b>

### Financial proposals

3.11. The financial package comprises a number of elements. These elements combine to determine the total allowed revenue that SPTL will be able to recover over RIIO-T1. Table 3 sets out SPTL's key financial parameters for RIIO-T1. These are broadly similar to the Initial Proposals with the exception that allowed revenues have been reduced by c£7m (see Supporting document).

**Table 3 – SPTL's key financial parameters for RIIO-T1**

Parameter	Value
Cost of equity (post-tax real)	7%
Cost of debt (pre-tax real)	Annually indexed using 10-year simple trailing average
Notional gearing	55%
Depreciation profile	Straight line: 20 years on existing assets, 45 years on new assets
Asset lives transition	One price control period (8 years)
Totex capitalisation rate	90%
<b>Total allowed revenue (best view) for RIIO-T1</b>	<b>£2,352m</b>

### Uncertainty mechanisms

3.12. SPTL set out in their business plan a range of mechanisms in the RIIO-T1 control to help it manage the potential uncertainty it has identified during the eight-year price control period.

3.13. One key uncertainty mechanism is the efficiency incentive rate which determines the percentage of underspend/overspend against expenditure allowed at the price control review that is kept by the company responsible. The remaining savings/losses are passed through to consumers. An efficiency incentive rate of 50% will apply to all expenditure for SPTL for RIIO-T1.

<sup>16</sup> This reflects the companies' view of the most likely outcome. It is based on the Gone Green 2020 scenario.

3.14. Table 4 sets out an overview of the uncertainty mechanisms. These are broadly identical to the Initial Proposals with the exception of the addition of a volume driver for shared use connections infrastructure. This uncertainty mechanism will cover shared use infrastructure for generation connections that are needed over and above SPTL's best view forecast.

**Table 4 - Uncertainty mechanisms applying to SPTL for RIIO-T1**

<b>Uncertainty</b>	<b>Proposed mechanism</b>
Totex efficiency incentive rate	50%
Volume of new generation connections	Volume driver for generation connections to flex revenues as the cumulative generation capacity deviates from 4,393MW, including an opex adjustment of 1% and adjustment for real price effects.
Volume of new shared use infrastructure	Volume driver for shared use infrastructure to flex revenues as customer requirements for installed capacity of assets during RIIO-T1 exceed the baseline capacity output 1,073MVA.
Wider reinforcement works	Within period revenue adjustment for projects that deliver additional transmission capacity at the boundary or sub-boundary of the main integrated transmission system. The revenue adjustment will include an opex adjustment equal to 1% of the value of the additional wider works output.
Mitigation of impacts of new infrastructure on visual amenity	Any requirements to be included in funding requests under SWW arrangements.
Non load related replacement/renewal	Within period revenue adjustment for two specific large projects.
Financial distress	Disapplication of the price control where outside the company's control.
Licence fees and business rates	Continue pass through.
Uncertain costs associated with enhancement of physical security	Subject to a reopener for costs incurred that exceed 1% of average annual forecast revenue after the application of the totex efficiency incentive rate. Specific windows for reopener in 2015 and 2018.
Work force renewal	Subject to a reopener in 2016 if additional funding needed.

## 4. Summary of Final Proposals for SHETL

### Chapter Summary

This chapter summarises the Final Proposals for SHETL.

### Introduction

4.1. This chapter summarises the key components of SHETL's Final Proposals. Further detail on each of the areas set out below is provided in Chapters 2-6 of the Supporting Document.

### Outputs and incentives

4.2. RIIO is an outputs-led framework. It is important that throughout the RIIO-T1 period, the TOs understand what they are expected to deliver and are held to account for delivery.

4.3. Table 5 summarises the outputs that SHETL has stated that it will deliver, and will be required to deliver, during RIIO-T1. It also outlines the associated incentives.

**Table 5 – SHETL's Outputs and incentive parameters for RIIO-T1**

<b>Output</b>	<b>Incentive</b>
Safety	Compliance with safety obligations set out by HSE. No financial incentive.
Reliability	Primary output based on Energy Not Supplied (ENS) with a 3% collar on financial penalties and a licence condition on minimum performance standard.  SHETL will make compensation payments to customers off supply for 6 hours or more with an additional payment at 12 hours or more if applicable
Availability	Prepare and maintain a Network Availability Policy. <sup>17</sup> No financial incentive.
Customer Satisfaction	Develop a customer satisfaction survey that will be subject to an incentive +/-1% of allowed revenue.
Connections	Requirement to meet existing legal requirements with a downside penalty of 0.5% of allowed revenue for failure to meet these requirements. In addition, SHETL will agree standards of service with stakeholders.
Environmental	This will comprise the following components: <ul style="list-style-type: none"> <li>• SF<sub>6</sub> – Baseline and methodology set for SF<sub>6</sub> emissions over RIIO-T1. Differences to baseline will be subject to a</li> </ul>

<sup>17</sup> We also note that, reflecting the coverage of the document, all parties have agreed that the policy should now more accurately be referred to as the Network Access Policy.




	<p>reward/penalty based on the non-traded carbon price for carbon equivalent emissions.</p> <ul style="list-style-type: none"> <li>• Losses – Baseline set for the expected impact of its proposed investment on modelled losses and requirement to report annually on contribution to reduced losses.</li> <li>• BCF – To incorporate carbon reduction into investment planning and use the new innovation supporting mechanisms to challenge this further. They will consult stakeholders on proposals in their summer 2012 Stakeholder Consultation.</li> <li>• Visual amenity – Requirement to demonstrate an ongoing commitment to a range of mitigation measures. Allowance available to reduce the impact of existing infrastructure.</li> <li>• EDR – Additional measures to focus on aspects of the roles of the transmission companies which may not be explicitly captured in the proposed RIIO-T1 incentives. We will finalise details separately.</li> </ul>
Wider works <sup>18</sup>	<p>Baseline wider works outputs of 300MW of additional network transfer capacity. To use SWW arrangements for additional SWW outputs (this could include outputs up to 16,000MW sub-boundary and boundary transmission capability over the baseline outputs).</p> <p>Materiality criteria of £50m for initiating such requests. All SHETL's wider works outputs will be subject to timely delivery standards.</p>

4.4. There are a number of areas where SHETL was required to and has subsequently undertaken further work on its outputs since the publication of our Initial Proposals. The main developments are as follows:

- Availability – SHETL along with SPTL and NGET has been very productive in progressing work in this area and have met on numerous occasions since the publication of the Initial Proposals. While there are still issues to resolve, significant progress has been made in developing aspects of the proposals. In particular, significant progress has been made in relation to the issues of transparency and the sharing of information which will be an important element of the new arrangements.
- Customer satisfaction – SHETL has set out how they are continuing to progress work in this area alongside SPTL and NGET. SHETL has provided more detail on its plans for developing its survey and noted its intention to carry out a dry-run of the survey over the summer and to feed results into the finalised incentive mechanism. SHETL also note its intention to continue to seek to develop objective KPIs that measure the quality of the service it offers along with terms of reference for the assessment of its stakeholder engagement to further substantiate the survey results.

<sup>18</sup> We are currently developing a framework to enable competition in electricity transmission. For the avoidance of doubt, projects treated as strategic wider works in RIIO FPs could be subject to that competitive process and therefore potentially delivered by a third party TO.



## RIIO-T1: Final Proposals for SP Transmission Ltd and Scottish Hydro Electric Transmission Ltd

- Environmental outputs – SHETL was required to provide further information in relation to its SF<sub>6</sub> emissions and its BCF. The additional information it has provided is as follows:
  - SHETL has provided a baseline for SF<sub>6</sub> emissions over RIIO-T1 taking into account additions of new gas insulated equipment covered by ex ante allowances. SHETL intend to augment this with new additions that are installed as part of its strategic wider works programme when these are taken forward. SHETL has proposed to adopt leakage rates which are broadly consistent with best practice. Differences to baseline will be subject to a reward/penalty based on the non-traded carbon price for carbon equivalent emissions.
  - SHETL intend to consult stakeholders on proposals on how they report on BCF and how they fully account for their environmental impacts in their summer 2012 Stakeholder Consultation.

4.5. We note the progress SHETL has made in each of these areas. We consider this progress is consistent with the outstanding requirements placed on SHETL. However, we note there is still work to be undertaken and the onus is on SHETL to ensure this work is completed in sufficient time to enable the new arrangements to come into place for the start of RIIO-T1. We will continue to monitor progress in these areas both up to 1 April 2013 and beyond to ensure that the arrangements meet the RIIO objectives of providing a network that delivers real value for consumers and facilitates a low carbon economy and a sustainable energy sector.

### **Innovation**

4.6. In its business plan SHETL set out a consideration of innovation through its plan as well as providing a specific innovation strategy. SHETL requested an annual NIA of 1% of allowed revenue.

4.7. In the Initial Proposals we noted that we did not consider that SHETL had provided sufficient justification for its requested NIA. We noted that we intend to provide SHETL an allowance of 0.5% as being consistent with the default position set out in our Strategy Decision document. However, we noted that we would consider any evidence provided for a higher allowance in developing Final Proposals.

4.8. SHETL provided Ofgem with additional information to support its case for a higher level of funding under the NIA. In light of the additional information it has provided, we do not consider SHETL has done enough to justify the 1% NIA it has requested. However, we do consider it has justified a greater allowance than the 0.5% default. Based on our assessment approach we consider that SHETL's Innovation Strategy equates to an increased allowance of 0.2% of allowed revenue.

4.9. As such SHETL's NIA will be set at 0.7% of its allowed revenue. Further in line with the Initial Proposals, SHETL's total NIA will be divided evenly across the eight years of the RIIO-T1 period. As also set out in the Initial Proposals, we intend to build protection into the licence to deal with the possibility that actual revenues are

lower than that forecast (as otherwise this would have the effect of over recovery of NIA).

### Cost efficiency

4.10. There are various costs that SHETL incurs as a TO and for which it seeks to recover revenue in its price control. Table 6 sets out the costs we propose to provide through Final Proposal to deliver SHETL's business plan. These are unchanged from Initial Proposals.

**Table 6 – Key cost parameters for SHETL**

Parameter	RIIO-T1 Total
	SHETL's Best view <sup>19</sup> (2009/10 prices)
Load-related capex (baseline)	£0.6bn
Load-related capex (subject to uncertainty mechanisms)	£3.2bn
Non-load related capex	£0.2bn
<b>Total capex</b>	<b>£4.0bn</b>
<b>Total controllable opex</b>	<b>£0.2bn</b>

### Financial proposals

4.11. The financial package comprises a number of elements. These elements combine to determine the total allowed revenue that SHETL will be able to recover over RIIO-T1. Table 7 sets out SHETL's key financial parameters for RIIO-T1. These are broadly similar to the Initial Proposals with the exception that allowed revenues have been reduced by c£5m (see para 5.27 of Supporting Document).

**Table 7 – SHETL's key financial parameters for RIIO-T1**

Parameter	SHETL proposal
Cost of equity (post-tax real)	7%
Cost of debt (pre-tax real)	Annually indexed using 10-year trailing average with bespoke weighting tracking investment profile
Notional gearing	55%
Depreciation profile	Straight line: 20 years on existing assets, 45 years on new assets
Asset lives transition	Two price control periods (16 years)
Totex capitalisation	90%
<b>Total allowed revenue (best view) for RIIO-T1</b>	<b>£3,027m</b>

<sup>19</sup> This reflects the companies' view of the most likely outcome. It is based on the Gone Green 2020 scenario.

## Uncertainty mechanisms

4.12. SHETL set out in its business plan a range of mechanisms to help it manage the potential uncertainty it has identified during the eight-year price control period.

4.13. One key uncertainty mechanism is the efficiency incentive rate which determines the percentage of underspend/overspend against expenditure allowed at the price control review that is kept by the company responsible. The remaining savings/losses are passed through to consumers. An efficiency incentive rate of 50% will apply to all expenditure for SHETL for RIIO-T1.

4.14. Table 8 sets out an overview of the uncertainty mechanisms. These are broadly identical to the Initial Proposals.

**Table 8 – Uncertainty mechanisms applying to SHETL for RIIO-T1**

Uncertainty	Proposed mechanism
Totex efficiency incentive rate	50%
Volume of new generation connections	Volume driver for 100% costs for sole use generation connections over the baseline of 1,168MW. A volume driver for delivery of shared use connections infrastructure that exceed baseline capacity output of 1,006MVA. Pass through 50% of costs and volume driver on 50% costs of atypical sole use and shared use generation connections with unit costs greater than £150k/MW and £166k/MVA respectively. The volume drivers include an adjustment for real price effects.
Wider reinforcement works	Within period revenue adjustment for projects that deliver additional transmission capacity at the boundary or sub-boundary of the main integrated transmission system. This will include an opex adjustment equal to 1% of the value of the additional wider works output.
Uncertain costs associated with: <ul style="list-style-type: none"> <li>• BT 21<sup>st</sup> Century Networks</li> <li>• enhancement of physical security</li> <li>• compensating landowners under wayleave</li> <li>• exceptional sub-sea cable faults due to third party damage or unforeseen environmental damage</li> </ul>	Reopener for uncertain costs associated with specified categories if incurred costs exceed a material amount. A material amount is defined as exceeding 1% of annual average forecast revenue after the application of the totex efficiency incentive rate. Specific windows for reopener in 2015 and 2018.
Financial distress	Disapplication of the price control where outside the company's control.
Licence fees and business rates	Continue pass through
Mitigation of impacts of new infrastructure on visual amenity	Any requirements to be included in funding requests under SWW arrangements.

## 5. Next steps

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### Chapter Summary

The purpose of this chapter is to set out the next steps in setting the RIIO-T1 price controls for SPTL and SHETL.

5.1. The Final Proposals will come into effect through changes to the transmission licences on 1 April 2013. The licence obligations will also be set out in a series of supporting methodologies. In addition we will be developing a set of Regulatory Instructions and Guidance (RIGs) for RIIO-T1. The RIGs will provide the framework under which we will monitor the performance of the TOs against their price control obligations.

5.2. The licence drafting process is underway. As an important part of this process we have formed a legal drafting working group covering both RIIO-T1 and RIIO-GD1. The group is chaired by Ofgem and comprises representatives from Ofgem, the TOs and the gas distribution companies (GDNs).

5.3. We intend to publish an initial consultation on licence drafting for all transmission companies including SPTL and SHETL alongside the Initial Proposals for NGET, NGG and the GDNs in July 2012. We intend to publish a further consultation on licence conditions in October 2012 and the Statutory Licence consultation in December 2012.

## Appendices

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## Appendix 1 - Consultation questions and responses

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1.1. In our Initial Proposals consultation (RIIO-T1: Initial Proposals for SP Transmission Ltd and Scottish Hydro Electric Transmission Ltd Ref: 16/12) Ofgem sought the views of respondents about a number of questions. The questions along with respondents' views are set out below.

### List of non-confidential respondees

List	Name
1	ABB Limited
2	Alstom Grid
3	Balfour Beatty Engineering Services Limited
4	Clancy Docwra
5	EDF Energy
6	Enterprise Major Projects
7	Electricity North West
8	Morrison Utility Services
9	National Grid
10	Prospect
11	RJ McLeod (Contractors) Ltd
12	RSPB Scotland
13	Scottish Government
14	Scottish Renewables
15	Scottish Hydro Electric Transmission Ltd
16	SP Energy Networks
17	University of Strathclyde – Engineering

### Summary of responses

1.2. Responses received by Ofgem which were not marked as being confidential have been published on Ofgem's website [www.ofgem.gov.uk](http://www.ofgem.gov.uk). Copies of non-confidential responses are also available from Ofgem's library.

1.3. The following is a summary of those responses which were received to the following two questions.

## **CHAPTER Two**

**Question 1:** Do you consider that SPTL has put forward a business plan that is suitable for forming the basis of its price control settlement?

## **CHAPTER Three**

**Question 1:** Do you consider that SHETL has put forward a business plan that is suitable for forming the basis of its price control settlement?

### **Overall**

1.4. We received 19 responses to the Initial Proposals consultation, including responses from SPTL and SHETL. Two of the responses were marked as confidential. In this appendix we summarise the SPTL and SHETL responses separately from those of third parties.

### **Process**

1.5. Nearly all third parties supported the suitability of SPTL's and SHETL's business plans, as set out in the Initial Proposals, for fast-tracking. Six respondents noted that the companies' business plans set out a clear strategy to respond to the need for major investment in system reinforcement to support the low carbon economy and security of supply.

1.6. A number of respondents highlighted other benefits that would be provided by the plans. One respondent noted that the implementation of the plans would contribute to new jobs and upskilling the existing workforce in Scotland. Another respondent noted its support for SHETL's plans to invest in its network in an environmentally sensitive manner to minimise the impact on Scotland's natural environment.

1.7. One respondent said it found it difficult to assess the companies' business plans because there were a number of related initiatives, such as SO incentives and details of the RIIO-T1 package itself, that were yet to be resolved. Accordingly, it considered it was too early to say whether the Initial Proposals struck the right balance of risk and affordability for consumers.

1.8. SPTL and SHETL welcomed the recommendation to fast-track their plans. Both raised similar points regarding the process going forward, namely:

- licence drafting should be finalised as soon as possible to provide greater certainty and this should be accompanied by the Financial Handbook
- to ensure no policy changes are introduced at a later stage, decisions relating to the RIIO-T1 price control should be set out in the Final Proposals, Financial Handbook and/or licence conditions.

1.9. In addition SHETL noted that:



- work on all related areas – SO incentives, Environmental Discretionary Reward, Competition in Electricity Transmission, Charging Volatility, Regulatory Ring Fencing and changes to Compliance arrangements – should be progressed as separate policy areas rather than as part of RIIO. It considered otherwise fast-tracked parties could be disadvantaged by the development of policy between their submissions and the commencement of the price control
- in so far as practical, obligations on the companies should be set out in the licence conditions rather than in secondary documents.

### *Stakeholder engagement*

1.10. Most stakeholders were very enthusiastic about the companies' engagement processes in developing their business plans. In particular, seven civil engineering and equipment service providers said that the transparency of SHETL's business plans allowed them to plan their recruitment and training needs, identify innovative solutions to challenges and to adopt a competitive price strategy which would result in cost efficiencies for SHETL.

1.11. Three respondents noted that they looked forward to ongoing stakeholder engagement with the companies throughout the implementation of the RIIO-T1 business plans.

1.12. Both SPTL and SHETL stressed the importance of ongoing stakeholder engagement. SHETL set out a plan to consult in July on an ongoing strategy for engagement and on a number of other outstanding areas.

### **Outputs and incentive mechanisms**

1.13. Five respondents commented on the proposed outputs and incentives outlined in the Initial Proposals.

### Safety, Reliability and secondary outputs

1.14. Both SHETL and SPTL supported the Initial Proposals in relation to safety.

1.15. SPTL set out the basis of its reliability outputs in line with the Strategy Decision document. SHETL supported the Initial Proposals as reflecting its proposed approach and noted its intention to consult on a methodology for setting out the basis for compensatory payment under its reliability outputs in summer 2012.

1.16. SPTL supported the methodology for the measurement of secondary outputs set out by Ofgem as being a fair way to assess the delivery of investment plans. However, it noted that there needed to be some refinement to take account of asset replacement activities that result in a change to the volume of assets and noted that it had recommended a solution as part of the network output measures review.

1.17. SHETL considered that Ofgem should confirm in the Final Proposals how it will undertake the assessment of secondary deliverables at the end of RIIO-T1/beginning of RIIO-T2 to ensure there is no misunderstanding of the required deliverables.

#### Connections

1.18. SPTL confirmed its intention to comply with all obligations relating to connections. They stressed the role of NGET in the connections process and noted that it was important that the introduction of penalties for non-compliance does not either compromise its working relationship with NGET or result in one party being penalised as a result of the actions of the other.

1.19. SHETL stated its commitment to a connections process that is accessible to all. It intends to consult on a Connections Guide in its summer 2012 stakeholder consultation.

#### Network Availability

1.20. One respondent said the incentives on network availability should be strengthened from a reputational incentive to a financial incentive. They argued that a reputational incentive was too weak as stakeholder awareness of the activities the TOs can undertake to make the most of existing capacity, such as implementing dynamic line ratings, was limited. One respondent thought there was a strong case in terms of consumer benefits for SPTL and SHETL to adopt dynamic line ratings and that this should be advanced through the innovation package.

1.21. Both SPTL and SHETL set out their commitment to continue to work to develop a Network Access Policy through the joint Ofgem-TOs Working Group. SHETL noted the importance of a viable outage programme to deliver its capital programme with minimal impact on constraint costs.

#### Customer satisfaction

1.22. Both SPTL and SHETL set out how they are continuing to progress work in this area alongside NGET. Both noted that the arrangements should recognise that all connected and connecting parties are first and foremost NGET's customers.

1.23. Both noted their plans for developing their surveys. SPTL noted its intention to complete and agree a survey pro-forma with a view to implementing a survey later this year. SHETL noted its intention to carry out a dry-run of the survey over the summer and to feed results into the finalised incentive mechanism. SHETL also note that, in parallel, it intends to continue to seek to develop objective KPIs that measure the quality of the service it offers along with terms of reference for the assessment of its stakeholder engagement to further substantiate the survey results.

### Environmental outputs

1.24. SHETL noted its intention to provide Ofgem their Sulphur Hexafluoride (SF<sub>6</sub>) baseline by the end of the month and will confirm whether it accepts the incentive arrangements set out in our Strategy Decision document ahead of publication of the Final Proposals.

1.25. SPTL noted its intention to report publicly on what they are doing to contribute to fewer losses and will publish the first report in June this year. SPTL set out a number of investments it is taking forward and the impact they could have in reducing losses.

1.26. Both SPTL and SHETL note that they are reviewing how they report on their Business Carbon Footprint (BCF). SPTL noted that its 2011 report will include third party data verification and an increase in the scope of their reporting. During 2012 SPTL intends to develop a Credit 360 based carbon reporting system to provide for carbon conversion, apportionment and enable remote reporting of contractors into its data collection systems. It notes that it has already funded investment in the development and provision of the required software for this work. SPTL also intends to develop an overall environmental strategy including carbon reduction and control strategies by end-April. SHETL noted that it is identifying the relevant datasets and identifying new areas for inclusion. It noted that it is considering developing a new process to ensure it fully accounts for its environmental impact and intends to consult with interested parties in summer 2012 before finalising.

1.27. SPTL supported the visual amenity allowance but considered it should be extended beyond National Parks and Areas of Natural Beauty (AONB) as it did not reflect equivalent protected designations in Scotland. SPTL also noted it would continue to engage with stakeholders on willingness to pay by supporting NGET's survey. SHETL retained the view that, reflecting the scale of its investment plans, it would not anticipate seeking funding to improve the visual amenity of existing assets. However, it welcomed the ability to access this allowance if required.

1.28. SHETL welcomed the opportunity to be able to demonstrate and receive recognition for efforts to minimise the environmental impact of its activities. However, it considered this should be dealt with outside of RIIO-TI rather than as an add-on to the proposals. Another respondent considered that there was a lack of new incentives in RIIO-T1 for the delivery of outputs. It welcomed the Environmental Discretionary Reward (EDR) in this regard, but also noted that, as the scope is only discretionary, it may lack sufficient strength to build an investment case with management.

### **Innovation**

1.29. Three respondents commented on innovation. One respondent strongly urged Ofgem to consider increasing all companies' NIAs to a level of greater than 1%. The respondent argued that innovation would be essential to achieve a low carbon transition and reliability at an affordable cost. It also considered it appropriate for

customers or taxpayers to fund the research and development needed to establish the viability of different transmission options given the uncertainty around the value of these activities for individual shareholders.

1.30. SPTL noted that while it was disappointed with Ofgem's Initial Proposal not to provide its requested NIA of 0.75%, it did not intend to put forward further information to support an NIA of higher than 0.5%. SPTL considered its efforts would be best focussed on mobilising innovation projects.

1.31. SHETL submitted further evidence to Ofgem to justify its request for a higher level of NIA funding. Its main justification for the additional allowance remained that this will allow a more rapid deployment of innovation into the business over the RIIO-T1 period. In addition to this previous justification, SHETL provided further supporting information for Ofgem to consider.

### **Cost efficiency**

1.32. Only SHETL explicitly commented on the cost assessment section of the Initial Proposals. SHETL noted that its baseline is challenging but that it is an appropriate challenge. However, it also noted that its opex allowance reflects its best view at the time of its business plan submission and that, in the event of a significant change to its obligations, there would need to be a mechanism to allow it to recover additional costs. It identified additional compliance reporting requirements as an example.

### **Financial issues**

1.33. Three respondents commented on the financial issues set out in the Initial Proposals.

1.34. One respondent considered there was limited explanation in the consultation on how risk had been considered in setting the allowed returns in the Initial Proposals. They considered that the differences between SPTL's and SHETL's Capex:RAV ratios was not reflected in the return set in the Initial Proposals (SHETL's ratio was twice as high as SPTL's). The same respondent noted that SPTL would bear more risk as it would have more of its allowances set at the start of the period.

1.35. SPTL made the following comments on the financial proposals:

- agreed that the proposed financial package is appropriate for its circumstances and presents a fair balance of risk and reward to be to the benefit of customers and stakeholders
- noted that it had not been able to verify Ofgem's Return on Regulatory Equity (RORE) calculations and that its own analysis had produced a slightly greater overall risk range and set out its own updated RORE range to support this view
- noted that it had evaluated the impact on SPTL of the application of a similar approach to cost of debt as SHETL's proposed bespoke weighting but that the

small resulting adjustments to the index would not justify the increased complexity of such a mechanism

- expressed concern that a sharp increase in interest rates could lead to a shortfall in funding against the actual cost of debt
- welcomed further information on Ofgem's previous commitment to carry out a review of related party margins in 2012.

1.36. SHETL made the following comments on the financial proposals:

- noted that the Initial Proposals should be seen as a single package and that, if there were any changes to the financial proposals, the whole package should be reviewed to ensure it remained financeable
- noted the position outlined by Ofgem that it would suffer no financial detriment from fast-tracking and that if the financial components as calculated under the licence model were reduced then SHETL should receive the necessary uplift to correct the position
- sought confirmation of its expectation that it would be eligible for the Information Quality Incentive (IQI) 'additional income' for projects funded under the SWW mechanism
- disagreed with the view that projects funded under the SWW mechanism would be able to outperform its totex allowance as it considers there to be an asymmetric risk associated with the scope for overspend.

### **Uncertainty mechanisms**

1.37. Six respondents commented on the proposed uncertainty mechanisms.

1.38. One respondent supported the proposed process for funding significant infrastructure projects and the associated stakeholder consultation process. Another respondent also supported the flexibility mechanisms to augment the fast-track RIIO package, should additional generation come forward. A third respondent welcomed the recognition of real price effects, and noted that longer-term price controls introduce greater uncertainty and risks in projecting future costs.

1.39. SHETL welcomed the support for the mechanisms set out in its plan. It made the following specific comments on finalising these mechanisms:

- remained unconvinced that provisions for costs associated with sub-sea cable faults should be included in totex as these would be a result of exceptional events eg third party damage, and therefore over and above routine operation and maintenance (O&M) costs
- recognised the need to undertake further work to define its logging up mechanism to cover the costs incurred in compensating landowners in relation to wayleaves
- considered provision should be made through the current Income Adjusting Events (IATt term) mechanism to cover the potential for legislative changes and/or changes to the System Operator-Transmission Owner Code (STC) that could result in significant additional costs for the TOs that are currently unfunded.

1.40. SPTL raised the following points on uncertainty mechanisms:

- supported the proposed use of uncertainty mechanisms in RIIO-T1 as protecting consumers' interests
- considered the proposed arrangement for dealing with exceptional costs in relation to the Western HVDC Link should change from only applying where one scenario (either related to weather, sea-bed or consents) resulted in a total cost increase of greater than 10% of total project value to reflect an increase of 10% from a combination of those events
- considered the benefits for consumers from competition relating to wider system works had not been demonstrated with sufficient certainty and that benefits to customers would be greater if third parties were responsible for the entire project including pre-engineering works.

*Strategic Wider Works (SWW)*

1.41. One respondent welcomed the clarity provided on the SWW process. It noted the importance of this process delivering decisions in a timely manner to enable the supply chain to mobilise effectively to deliver projects efficiently. It considered that a guidance document providing greater clarity on how the framework would operate would build industry confidence.

1.42. While welcoming the proposed SWW arrangements, SHETL raised a few areas where it considered greater clarity was required. These were:

- if Ofgem has accepted a needs case then there should be no need to revisit the merits of a project at a later stage
- the need to provide sufficient certainty to commit to the contract required to progress with a project – particularly where a project spans the T1/T2 boundary
- the assessment timeframe should not be too rigid and the needs assessment and project assessment should be able to run concurrently over a period of 6-9 months.

1.43. SPTL expressed concern with Ofgem's proposal to only apply a revenue trigger for reopeners for projects greater than £100m. Given experience for considerable variation in collector costs across their network it considered this approach could result in underfunding in certain circumstances. It welcomed Ofgem's willingness to consider a funding approach for projects below this threshold based on unit costs for substation and overhead lines and noted its intention to provide relevant information in this area.

1.44. SPTL also noted its proposal for an output for existing collectors linked to the current level of contracted generation that will be connected through those collectors. It noted that given the contracted capacity will change over RIIO-T1 then this output would need to be updated within period.

1.45. Both SPTL and SHETL considered that our proposed penalty cap for the late delivery of wider works (10% of allowed revenue) was disproportionate. SPTL proposed a cap of £10m (circa 3% of allowed revenue). It also noted that delays to SWW projects should be assessed on a case-by-case basis. SHETL argued that a cap of 5% of baseline allowed revenue in the year that the construction of the project commenced would give greater certainty as to the consequences of late delivery. SHETL requested Ofgem provide a set of transparent guidelines for how a penalty for late delivery would be determined and the timetable for that process as part of the Final Proposals.

## Appendix 2 – RIIO-T1 Timetable

Phase	Year	Month	Milestone	
Initial Proposals Fast-Track	2012	January	Monday 23rd - T1 Decision on Fast-Track Published	
		February	Tuesday 7th - Initial Proposals Published for SPTL and SHETL	
Resubmission of business plan Non-Fast-Track		March	Tuesday 2nd - NGET and NGG submit revised business plans	
Final Proposals Fast-Track		April	Thursday 19th - GEMA - SPTL and SHETL Final Proposals Decision Monday 23rd - SPTL and SHETL Final Proposals Published	
		July	Thursday 26 <sup>th</sup> - GEMA - Non-Fast-Track Initial Proposals Late July - Non-Fast-Track Initial Proposals Published Initial consultation on licence drafting <u>for all TOs and GDNs</u>	
Final Proposals Non-Fast-Track		October	Second consultation on licence drafting <u>for all TOs and GDNs</u>	
		December	Thursday 13th - GEMA - Non-Fast-Track Final Proposals Decision Monday 17th - Non-Fast-Track Final Proposals Published Statutory Consultation on Licence Mods	
			February	New licences and RIGs issued
Launch		2013	April	Monday 1 <sup>st</sup> - New Price Controls Commence



## Appendix 3 - Feedback Questionnaire

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1.1. Ofgem considers that consultation is at the heart of good policy development. We are keen to consider any comments or complaints about the manner in which this consultation has been conducted. In any case we would be keen to get your answers to the following questions:

1. Do you have any comments about the overall process, which was adopted for this consultation?
2. Do you have any comments about the overall tone and content of the report?
3. Was the report easy to read and understand, could it have been better written?
4. To what extent did the report's conclusions provide a balanced view?
5. To what extent did the report make reasoned recommendations for improvement?
6. Please add any further comments?

1.2. Please send your comments to:

**Andrew MacFaul**  
Consultation Co-ordinator  
Ofgem  
9 Millbank  
London  
SW1P 3GE  
[andrew.macfaul@ofgem.gov.uk](mailto:andrew.macfaul@ofgem.gov.uk)