

To: Scottish Hydro Electric Transmission plc

**Electricity Act 1989
Section 11A(1)(a)**

**MODIFICATION OF THE ELECTRICITY TRANSMISSION LICENCE HELD BY
SCOTTISH HYDRO ELECTRIC TRANSMISSION PLC AND GRANTED UNDER
SECTION 6(1)(b) OF THE ELECTRICITY ACT 1989**

Whereas –

1. Scottish Hydro Electric Transmission plc (“the Licensee”) is the holder of an electricity transmission licence (“the Licence”) granted or treated as granted under section 6(1)(b) of the Electricity Act 1989 (“the Act”).
2. In accordance with section 11A(2) of the Act, the Gas and Electricity Markets Authority (“the Authority”) gave Notice on the 27th June 2014 (“the Notice”) that it proposed to modify special condition 2M (Specification of Network Replacement Outputs) of the Licence and required any representations to the modification to be made on or before the 25th July 2014.
3. In accordance with section 11A(4)(b) of the Act, the Authority gave notice of its intention to make the modifications to the Secretary of State and has not received a direction not to make the modification.
4. Prior to the close of the consultation period in respect of the Notice, the Authority received no representations.
5. The Authority gives the following reasons for making the licence modification: to formalise the specification of the Licensee’s Network Replacement Output targets for the end of RIIO-T1 period¹.
6. The effect of the modification will be to specify the Network Replacement Outputs that the Licensee must deliver during the RIIO-T1 Price Control Period to assist the Authority in assessing any incentive reward or penalty associated with material over or underdeliveries against those outputs.
7. Where an application for permission to appeal the Authority’s decision is made to the Competition and Markets Authority (CMA) under section 11C of the Act, Rule 5.7 of the CMA’s Energy Licence Modification Appeals Rules² requires that the appellant must send to any relevant licence holders who are not parties to the appeal a non-confidential notice setting out the matters required in Rule 5.2. The attached Schedule 2 provides a list of the relevant licence holders in relation to this modification. The meaning of “relevant licence holder” is set out in section 11A(10) of the Act.

Now therefore

In accordance with the powers contained in section 11A(1)(a) of the Act, the Authority hereby modifies the Licence of Scottish Hydro Electric Transmission plc in the manner

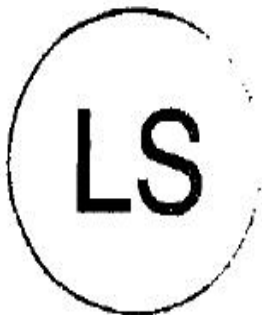
¹ The Network Replacement Outputs are used to measure licensees’ asset management performance. Licensees are set targets (for the end of the RIIO-T1 Price Control Period) that relate to the risk of their network assets. They are incentivised to exceed these targets by efficiently reducing risk to below target levels and penalised for failing to meet targets.

² The rules were published by the Competition Commission in September 2012. On 1 April 2014, the Competition Commission was abolished and its functions transferred to the Competition and Markets Authority.

specified in attached Schedule 1. This decision will take effect on and from 25 September 2014.

This document constitutes notice of the reasons for the decision to modify the electricity transmission licence held by Scottish Hydro Electric Transmission plc as required by section 49A of the Act.

**The Official Seal of the Gas and Electricity Markets Authority
here affixed is authenticated by the signature of**



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Paul Branston
Associate Partner, Costs and Outputs, Smarter Grids and Governance
Duly authorised on behalf of the Gas and Electricity Markets Authority

30 July 2014

Schedule 1 - Special Condition 2M as Modified

Special Condition 2M. Specification of Network Replacement Outputs

Introduction

2M.1 The purpose of this condition is to specify the Network Replacement Outputs the licensee must deliver during the Price Control Period, and the incentive reward or penalty associated with material over or underdeliveries against those outputs, and the allowed expenditure associated with them.

Part A: Specification of Network Replacement Outputs

2M.2 Subject to paragraph 2M.3 of this condition, by the end of the Price Control Period the licensee must deliver the Network Replacement Outputs in accordance with the specifications set out in Table 1.

Table 1: Network Replacement Outputs

Asset categories		Units	Asset distribution based on Replacement Priority at 31 March 2021			
			Replacement Priority (where RP1 is highest risk category)			
			RP1	RP2	RP3	RP4
400KV Network						
1	Circuit Breaker	Units	<u>0A1</u>	<u>0A2</u>	<u>0A3</u>	<u>0A4</u>
2	Transformer	Units	<u>0B1</u>	<u>0B2</u>	<u>0B3</u>	<u>0B4</u>
3	Reactors	Units	<u>0C1</u>	<u>0C2</u>	<u>0C3</u>	<u>0C4</u>
4	Underground Cable	Km	<u>0.0D1</u>	<u>0.0D2</u>	<u>0.0D3</u>	<u>0.0D4</u>
5	OHL conductor	Km	<u>0E1</u>	<u>0E2</u>	<u>0E3</u>	<u>0E4</u>
6	OHL fittings	Km	<u>0F1</u>	<u>0F2</u>	<u>0F3</u>	<u>0F4</u>
7	OHL towers	Units	<u>0G1</u>	<u>0G2</u>	<u>0G3</u>	<u>0G4</u>
275KV Network						
1	Circuit Breaker	Units	<u>1H1</u>	<u>0H2</u>	<u>0H3</u>	<u>81H4</u>
2	Transformer	Units	<u>10H1</u>	<u>0I2</u>	<u>0I3</u>	<u>16I4</u>
3	Reactors	Units	<u>0J1</u>	<u>0J2</u>	<u>0J3</u>	<u>7J4</u>
4	Underground Cable	Km	<u>0.0K1</u>	<u>0.0K2</u>	<u>0.0K3</u>	<u>4.3K4</u>
5	OHL conductor	Km	<u>0L1</u>	<u>0L2</u>	<u>0L3</u>	<u>1649L4</u>
6	OHL fittings	Km	<u>0M1</u>	<u>0M2</u>	<u>0M3</u>	<u>1649M4</u>
7	OHL towers	Units	<u>0N1</u>	<u>0N2</u>	<u>0N3</u>	<u>2550N4</u>
132KV Network						
1	Circuit Breaker	Units	<u>4O1</u>	<u>2O2</u>	<u>0O3</u>	<u>201O4</u>
2	Transformer	Units	<u>2P1</u>	<u>8P2</u>	<u>1P3</u>	<u>141P4</u>
3	Reactors	Units	<u>0Q1</u>	<u>0Q2</u>	<u>0Q3</u>	<u>0Q4</u>
4	Underground Cable	Km	<u>0.0R1</u>	<u>0.0R2</u>	<u>9.6R3</u>	<u>83.6R4</u>
5	OHL conductor	Km	<u>56S1</u>	<u>124S2</u>	<u>187S3</u>	<u>2800S4</u>
6	OHL fittings	Km	<u>0T1</u>	<u>0T2</u>	<u>0T3</u>	<u>3166T4</u>
7	OHL towers	Units	<u>0U1</u>	<u>0U2</u>	<u>0U3</u>	<u>8462U4</u>

~~2M.3~~ The licensee must submit proposed values for the terms A1,A2,A3,A4,B1,B2,B3,B4,C1,C2,C3,C4,D1,D2,D3,D4,E1,E2,E3,E4,F1,F2,F3,F4,G1,G2,G3,G4,H1,H2,H3,H4,I1,I2,I3,I4,J1,J2,J3,J4,K1,K2,K3,K4,L1,L2,L3,L4,M1,M2,M3,M4,N1,N2,N3,N4,O1,O2,O3,O4,P1,P2,P3,P4,Q1,Q2,Q3,Q4,R1,R2,R3,R4,S1,S2,S3,S4,T1,T2,T3,T4,U1,U2,U3 and U4 within 30 days of 1 April 2013. The Authority will determine values for these terms taking account of this submission.

~~2M.4~~2M.3 The licensee shall also be deemed to have delivered a particular Network Replacement Output for the purposes of paragraph 2M.2 of this condition, notwithstanding a failure to meet the relevant specifications in Table 1 of this condition, if by the end of the Price Control Period:

- (a) it delivers an equivalent level of risk to the Network Replacement Output specified in Table 1 of this condition (a “materially equivalent output”); or
- (b) it delivers the Network Replacement Output or a materially equivalent output to a lower level of risk than that set out in Table 1 of this condition, but that overdelivery is justified in accordance with the RIIO Principles (a “justified material overdelivery”); or
- (c) it delivers the Network **Replacement** Output or a materially equivalent output to a higher level of risk than that set out in Table 1 of this condition, or delivers neither the Network **Replacement** Output or a materially equivalent output, but that underdelivery is justified in accordance with the RIIO Principles (a “justified material underdelivery”).

~~2M.5~~2M.4 The Authority shall assess the licensee’s performance under paragraphs 2M.2 and 2M.34 of this condition in accordance with the process set out in Part B of this condition for the purposes of determining whether adjustments should be made to allowed expenditure in the second price control period (to commence 1 April 2021) in accordance with the principles set out in the table in Part C of this condition.

~~2M.6~~2M.5 In assessing whether the licensee should be deemed to have delivered a particular Network **Replacement** Output under paragraph 2M.34 of this condition the Authority will, amongst other things, take account of any trade-offs between asset categories which the licensee is able to demonstrate has or are likely to deliver an equivalent or better set of Network Replacement Outputs to those specified in Table 1 of this condition.

Part B: Procedure for assessing Network **Replacement Outputs and associated Price Control Allowed Expenditure Adjustments**

~~2M.7~~2M.6 By 31 July 2021 the licensee must provide a report to the Authority (the “Performance Report”) setting out the extent to which it has complied with paragraph 2M.2 of this condition, including (as relevant) detailed explanations together with supporting evidence as to why the licensee considers that it has delivered:

- (a) a Network **Replacement** Output in accordance with the relevant specifications set out in Table 1;
- (b) any materially equivalent outputs;
- (c) any justified material overdelivery; or
- (d) any justified material underdelivery.

~~2M.8~~2M.7 The licensee must provide such further analysis or information, and in accordance with such timescales, as the Authority considers is reasonably necessary to enable it to undertake its assessment for the purposes of its determination under paragraph 2M.5 of this condition.

~~2M.9~~2M.8 A determination by the Authority under Part B of this condition will be of no effect unless the Authority has first:

- (a) given notice to the licensee and to any other interested parties that it proposes to make the determination:
 - (i) stating the reasons for and the effects of its proposed determination; and
 - (ii) specifying the time (which must not be less than a period of 56 days) within which representations concerning the proposed determination may be made; and
- (b) considered any representations in response to the notice that are duly made and not withdrawn.

Part C: Principles for determining adjustments to allowed ~~expenditure~~ revenue

~~2M.10~~2M.9 The Authority will determine whether adjustments should be made to allowed ~~revenue~~ revenue in the second price control period (to commence 1 April 2021) in accordance with the principles set out in Table 2 ~~below~~.

Table 2: Treatment of under- and over-delivery of Network Replacement Outputs

Incentives	Justified	Unjustified
Material over-delivery	<p>Cost of over-delivery shall be included in the second price control period allowances</p> <p>The financing cost incurred by the licensee in advancing investment shall be reimbursed</p> <p>Reward of 2.5 per cent of the additional costs associated with the material overdelivery</p>	<p>Cost of over-delivery shall be included in the second price control period allowances</p> <p>The licensee shall incur the financing cost of earlier investment</p>
Under-delivery	<p>Cost of under-delivery shall be excluded from the second price control period allowances</p> <p>The licensee shall benefit from the financing cost of delayed investment</p>	<p>Cost of under-delivery shall be excluded from the second price control period allowances</p> <p>The benefit arising to the licensee from the financing cost of delayed investment shall be clawed back</p> <p>Penalty of 2.5 per cent of the avoided costs associated with the material underdelivery</p>

Part D: Allowed expenditure for Network Replacement Outputs

2M.10 The allowed expenditure figures to deliver the Network Replacement Outputs are set out in Table 3. These allowances have been reflected in the licensee's Opening Base Revenue Allowance, set against the licensee's name in Appendix 1 to Special Condition 3A (Restriction of Transmission Network Revenue).

Table 3: Allowed expenditure for Network Replacement Outputs

<u>Relevant Year</u>	<u>Allowed expenditure (£m 2009/10 prices)</u>
<u>2013/14</u>	<u>21.723</u>
<u>2014/15</u>	<u>20.127</u>
<u>2015/16</u>	<u>23.109</u>
<u>2016/17</u>	<u>27.430</u>
<u>2017/18</u>	<u>28.617</u>
<u>2018/19</u>	<u>28.986</u>
<u>2019/20</u>	<u>31.337</u>
<u>2020/21</u>	<u>27.765</u>

Schedule 2 - Relevant licence holders for the purpose of this modification

The following are the relevant licence holders according to the meaning set out in section 11A(10) of the Electricity Act 1989.

1. Scottish Hydro Electric Transmission plc
Inveralmond House
200 Dunkeld Road
Perth
PH1 3AQ