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Dear Kersti,

Consultation on an assessment of the Caithness Moray transmission project

National Grid welcomes the opportunity to respond to the above consultation. We welcome that Ofgem is providing transparency and is seeking views as the Strategic Wider Works (SWW) process develops. In particular, the role of this consultation as part of the process that clarifies proposed funding arrangements.

This response is on behalf of National Grid Electricity Transmission plc (NGET) and is not confidential. In addition to the questions asked, further clarity would be helpful on cost benchmarking, the approach to uncertainty on the outturn costs, and what level of detail is required throughout the SWW process to ensure efficient outcomes in the interest of consumers. Our answers to the specific questions in the Consultation are contained in the attached Appendix, as well as our comments on these other items of relevance.

One issue raised is the potential for unintended consequences for our customers and stakeholders concerning the timing of revenue recovery. SHE Transmission must notify us of their allowed revenue before the 25 January 2015 deadline. This enables us to calculate TNUoS tariffs for 2015/16 and to inform customers of their charges in line with our obligations. If this is not achieved, then there is a risk that a mid-year tariff change may be necessary. Our response details this, and following this consideration we welcome further discussion with Ofgem on this matter.

We welcome the opportunity to discuss the views contained within this response further as part of our regular engagement with you and your team. For further details, please contact Chris Bennett (Chris.Bennett@nationalgrid.com).

Yours sincerely,



Mark Ripley
Director of UK Regulation

Appendix: Detailed questions within the Consultation

Q 1 Based on the information in this consultation and our consultants' report, do you agree with our assessment on the proposed efficient costs for the CM project?

In general, NGET believes that the overall levels of efficient costs should be debated and resolved between Ofgem and the relevant TO. This is because both parties have better and more detailed information available on the project to make an informed view on the efficient delivery costs required.

However, we do recognise the scale and complexity of this project. For these “one of a kind” type projects there is a need to ensure they have a strong project management team in place to deal with issues as they arise in a timely manner. This will ensure that any challenges which may arise do not result in either delay to the project and / or increased costs to the end consumer.

Q2 What are your views on the arrangements for dealing with uncertainty on the outturn costs?

We welcome Ofgem's concern on how uncertainty on outturn costs is managed under SWW projects.

We acknowledge that the Transmission Licence has a provision for changes in outturn costs for SWW, referred to as the Cost and Output Adjusting Event (COAE). The provision allows for changes that are no less than a stated percentage of the total Allowed Expenditure for the affected SWW project (referred to in the following text as a 'trigger'), and only for strictly defined and one-off events.

Whilst it is possible that this trigger could be met over the whole construction programme, it is also possible that additional costs could be incurred that are still below the trigger. Therefore, in order to ensure that these risks are adequately covered, TOs need to build in an appropriate risk margin into their SWW submission to reflect the risk being borne up to the trigger thresholds. Therefore, there is potentially a benefit in reviewing the regulatory treatment of the COAE approach to ensure that TOs are suitably funded for undertaking SWW projects, and also that there are no windfall losses or gains to TOs or electricity consumers as a result of, or indeed lack of, the strictly defined events emerging.

Therefore, consideration could be given to alternative and potentially more sophisticated ways to manage risk and we would welcome further discussion with Ofgem, TOs and other key stakeholders.

Given the scale and complexity of this project we recognise that a sophisticated risk model would have to be developed and reviewed and therefore it's not possible for us to comment directly with respect to overall risk provision proposed by Ofgem. However, we would reiterate our earlier observation with regard to the need to establish a strong project management team, which is adequately resourced to manage these risks as they occur.

Q3 What are your views on updating SHE Transmission's revenue model in January 2015 instead of November 2014 so that the allowed expenditure for the CM project is incorporated into the company's 2015/16 revenues?

In its consultation, Ofgem proposes to update SHE Transmission's revenue model in January 2015 instead of November 2014. On review, NGET has identified two impacts that this proposed change would have on the annual charge setting process and for customers:

- i. National Grid needs early and effective information from each Transmission Licensee to calculate TNUoS tariffs and to suitably inform customers of their charges. The process for this is set out in SO-TO Code Procedure *STCP 14-1 Data Exchange for Charge Setting*. A key milestone of *STCP 14-1* process is that TOs will update and provide a final forecast of their allowed revenue by 25 January. This then allows NGET to finalise TNUoS tariffs by 31 January in accordance with the CUSC.

Therefore, in the event Ofgem delays the determination of MOD and the information is not included correctly in the 25 January submission, there is a risk of NGET under or over recovering the revenues of SHE Transmission. *STCP14-1* only allows Transmission Owners to deviate from their 25 January submission in exceptional circumstances. This would be a concern for us as we are incentivised to get this right, and therefore any significant changes to TOs information may lead to a mid-year tariff change that would counter the charging stability that our customers desire.

NGET would like to highlight that the 25 January 2015 falls on a Sunday. As a result, each Transmission Licensee will be required to submit their information to NGET by the 23 January 2015.

- ii. The timing of including SWW in the annual charge setting process could result in charging volatility and market uncertainty. For example, NGET's quarterly forecast, issued on the 14 October 2014, referred to the Caithness Moray project but excluded its impact. This was because, at the time of publication, no information was available to NGET or SHE Transmission to indicate funding would be provided in 2015/16. We estimate that including revenue for the Caithness Moray project in 2015/16 will increase the GB weighted average Half Hour Demand TNUoS tariffs by £1.33/kWh (3.6%) to £1.62/kWh (4.3%) compared to what was forecast in October 2014. There is minimal impact on Generation TNUoS Tariffs due to the cap on average annual generation charges. Therefore, overall SHE Transmission's impact on the average domestic customer bill will increase by nearly £1.

Feedback from recent industry charging fora indicates uncertainty amongst suppliers and end consumers whether Ofgem's proposals and the resulting increase in demand charges will be realised. Some suppliers may include the increase in their tariffs whereas others may not, creating a temporary divergence in market tariffs. NGET will publish its draft TNUoS tariffs in mid-December but delaying the MOD determination to January 2015 extends this period of market uncertainty.

We welcome further clarity and see there is merit in a discussion with industry on the points raised above. We would be happy to participate in the discussion and input into charging fora.

Q4 Do you have any other comments or information relevant to our assessment?

We have three comments we would like to raise on Ofgem's assessment to ensure TOs have adequate guidance to support the SWW process. To enable TOs to provide high quality SWW submissions, addressing Ofgem's needs to enable appropriate scrutiny on behalf of consumers, further clarity in the following areas would be helpful:

- i. The consultation refers to Ofgem's deemed efficient cost levels. We welcome increased transparency around appropriate benchmarks, in particular cost and output levels being achieved. Benchmarks need to be taken in the context of SWW projects which are often significant "one of a kind" type projects which may have specific environmental or engineering challenges. There is a risk that reliance on benchmarks could overlook

project specific or site specific factors that have led to real efficient cost levels above the basis of average type benchmarks. Increased transparency around benchmarks would ensure TOs are able to differentiate their project costs against Ofgem's standard / average benchmarks and describe where it is more or less difficult than average to achieve an output. Furthermore, NGET seeks guidance on how Ofgem intends to consider project and site specific requirements. It should be noted that there are different approaches (e.g. contracting etc.) that may lead to different costs of individual elements of the project, but in practice the total outcome is the same.

- ii. We welcome Ofgem's acknowledgment that planning processes impact the nature of the solution we and other TOs bring for cost assessment. The consented solution is often not the minimum economic cost solution, but the minimum cost solution that our wider customer and stakeholders have input to and support, and therefore is the minimum cost consentable solution. It is often also subject to Government approval through a planning enquiry. NGET seeks clarity from Ofgem on how it will deal with the interaction between a consentable solution arrived through planning and the cost trade-offs necessary to have a consentable project. In recognition that there is a strong interaction between the Development Consent Order (DCO) and SWW processes. For example, the development of the detailed design of the project is informed and influenced by stakeholder's views (for example, statutory stakeholders and local community groups), received during the consultation process to support the DCO.
- iii. In acknowledgement to the points where further information requests were required to address Ofgem's needs to enable appropriate scrutiny on behalf of consumers. Further information, in addition to Ofgem's 'Guidance on the Strategic Wider Works arrangements in the electricity transmission price control, RIIO-T1' document published on 21 October 2013, would be supportive of an efficient outcome (e.g. to describe the level of detail and elements of works expected, and the desired format, for each stage of the SWW process). Particularly we welcome additional clarity on the differentiation between a need case as compared with a project assessment. This is because we see key differences in the level of detail available at needs case stage and project assessment, but believe there is a risk that demonstrating a needs case could substantially develop into a debate about cost levels prior to detailed costing information being available.