

Transmission licensees,
generators, suppliers, consumer
groups and any other party who
has an interest in the
transmission arrangements

Date: 4 March 2015

Dear Stakeholder,

Decision on SP Transmission Ltd's opening asset value for the England-Scotland Interconnector project

The England-Scotland Interconnector project is an electricity transmission investment to increase network capacity on the England-Scotland border. It has been funded under the Transmission Investment for Renewable Generation (TIRG) mechanism¹. The project involved work on the networks of both National Grid Electricity Transmission plc (National Grid) and SP Transmission Ltd (SPT). This decision concerns SPT's work on the project. The outputs associated with SPT's work were delivered in 2010-11.

The TIRG conditions require us to determine the post-construction Opening Asset Value (OAV)². This finalised value determines the revenue that SPT receives for the 5 years following construction.

On 18 December 2013 we consulted on our initial view that the project outputs had been met in 2010-11 and that the OAV for SPT's work on the England-Scotland Interconnector project should be £76.7m³. Having considered all relevant factors and the one response received to our consultation, this decision confirms that the OAV will be £76.7 million. This is the original forecast of the OAV set out in the TIRG conditions.

Background to TIRG

The TIRG mechanism was established in 2004 to fund transmission projects to connect renewable generation outside the price control process. The intention was to minimise investment delays. TIRG gives the three electricity Transmission Owners (TO)⁴ expenditure allowances for specific transmission reinforcement projects. Since the design and associated costs of these projects were uncertain, a degree of flexibility was built into the mechanism to allow the revenue allowances for each project to be amended where justified.

¹ "TIRG mechanism" and "TIRG conditions" are used interchangeably within this letter to refer to the conditions of Special Condition 3J of SPT's electricity transmission licence, which governs the "Transmission Investment for Renewable Generation (TIRG)" arrangements.

² This determines the revenue allowances for the five year incentive period under the TIRG mechanism.

³ All values in this document are in 2009-10 prices unless otherwise stated.

⁴ Namely Scottish Hydro Electric Transmission Plc (SHE Transmission), SPT and National Grid Electricity Transmission.

The various TIRG projects, including the England-Scotland Interconnector, can be broken down into four distinct phases and defined as follows:

| Pre-construction | Construction | Post-Construction⁵ period | Regulated Asset Value⁶ period |
|------------------------------|---|---|---|
| Period prior to construction | Period of construction. The length of the construction period is set out in the Licence with an annual revenue allowance set for each year. | Period of 5 years which begins one year after output is delivered | 15 year period during which any savings are shared with consumers |

During the five-year post-construction period, which starts the year after construction ends, the TOs can keep cost savings if they efficiently deliver the project for below forecasted cost. This gives TOs an incentive to deliver projects efficiently. At the end of this period, any cost savings are passed on to consumers.

Background to the England-Scotland Interconnector project

The England-Scotland interconnector works were designed to increase the capability of the boundary⁷ between England and Scotland from 2200MW to 2800MW by upgrading both of the west and east coast circuits.

SPT commenced its works for the England-Scotland interconnector in 2006. The scheme was completed and put into full service in 2010. On 21 January 2013, SPT submitted its post-construction technical and expenditure reports for the project to us. As required by the TIRG conditions, the post-construction expenditure report⁸ was accompanied by an independent auditor's statement. The post-construction technical report was accompanied by a construction completion certificate from independent technical advisors. It set out the actual capability of the network covered by the project and confirmed SPT's compliance with the output measures set out in Schedule C of the TIRG conditions.

December 2013 consultation

We published a consultation in December 2013 which set out our initial view on the OAV for this project. The consultation set out our view that SPT's expenditure on the project was efficient. It also explained that we felt that the project was delivered on time (ie in 2010-11) and that it was appropriate for the post construction allowances to begin in 2011-12. Based on this, we proposed that the OAV should not change from the £76.702 million value set in the licence.

⁵ In the licence this term is referred to as the 'incentive period' and also as 'the TIRG relevant years'

⁶ See Glossary of terms: RIIO-T1 and GD1 review: <https://www.ofgem.gov.uk/ofgem-publications/48279/glossary.pdf>

⁷ Boundaries are used to split the transmission system into different areas in order to assess and report on system capability

⁸ A copy of the post-construction technical report was published alongside our December 2013 consultation here: <https://www.ofgem.gov.uk/publications-and-updates/consultation-opening-asset-value-england-scotland-interconnector---transmission-investment-renewable-generation-project>

Responses to the consultation

We received one response to our consultation which has been placed on our website⁹. The response was supportive of our initial view of the OAV. The respondent (SPT) noted that the original forecast cost of the project was £88.6 million and not £86.6 million, which was incorrectly quoted in our consultation.

Our Determination

We have carefully considered all the information before us, including the post-construction expenditure and technical reports submitted by SPT, other relevant information and the response received to the December 2013 consultation. We are satisfied that all relevant criteria and requirements set out in the TIRG licence condition have been met. In particular, we consider that SPT delivered the output measures set out in Schedule C of the TIRG condition in 2010-11.

For the reasons set out above, the Authority determines that the OAV (described as "SAFTIRG" in the TIRG condition) for the England-Scotland interconnector for the five year incentive period should be £76.702 million.

Setting the Opening Asset Value

When determining the OAV, we are required to consider the following criteria:

- Whether an adjustment has been made to the average asset value and depreciation value for the transmission investment project during the construction period.
- Whether the final aggregate transmission investment expenditure set out in the post-construction expenditure report has been efficiently incurred.
- Whether the licensee has complied with the output measures specified in Schedule C of the TIRG condition for the transmission investment project.
- Any other information the Authority considers to be relevant to the determination.

These points are discussed below in relation to our determination on SPT's OAV for the England-Scotland Interconnector project.

Reasons for the Authority's decision

Efficiency of costs incurred

The final aggregate expenditure incurred by SPT is £79.0 million, compared to £88.6 million originally forecast. Given that the scope of works covered by the TIRG mechanism has not changed, we consider that the expenditure was appropriate to deliver the output measures, with the cost saving representing efficient delivery of project's outputs.

Compliance with project-specific outputs

We note that the construction completion certificate states that SPT has completed all construction activities necessary to fulfil its output measure obligations specified in Schedule C of the TIRG condition. The data gathered and technical review carried out by the independent technical advisor confirms that the output measures have been fully delivered for all elements of the England-Scotland interconnector works carried out by SPT.

⁹ <https://www.ofgem.gov.uk/publications-and-updates/consultation-opening-asset-value-england-scotland-interconnector---transmission-investment-renewable-generation-project>

Asset Value Adjusting Event

No adjustment has been made to the average asset value or to the depreciation value during the construction period.

Any other information the Authority considers to be relevant to the determination

We have reviewed all other relevant information, including the reports submitted to date by National Grid in respect of the completion of its works for the England-Scotland interconnector.

We have not considered the value of the revenue allowances after the end of the five year incentive period. In the summer of 2015, we intend to consult on how revenue allowances will be set for TIRG projects that move beyond the post-construction period.

If you have any questions regarding this letter, please contact Thomas Johns on 020 7901 7046 or Thomas.Johns@ofgem.gov.uk.

Yours faithfully,

Kersti Berge
Partner, Electricity Transmission
For and on behalf of the Authority