

Transmission licensees, generators,
suppliers, consumer groups and other
interested parties

Your Ref:
Our Ref:
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Date: 29 July 2015

Dear Colleague,

Post construction review of SHE Transmission's Beaully-Denny project – proposed process and timings

This letter informs stakeholders of the process we intend to follow to reach a decision on SHE Transmission's revenue allowance for the delivery of the Beaully-Denny project. If our decision affects SHE Transmission's allowed revenue, we would expect any changes to revenues and TNUoS charges to take effect from 1 April 2017.

The Beaully-Denny project

Beaully-Denny is an electricity transmission project to upgrade the capacity of the key strategic line between Beaully in the north of Scotland and Denny in central Scotland. It is being delivered jointly by SHE Transmission and SP Transmission and is due to be energised in November 2015. Under the terms of the TIRG mechanism under which the project is funded, a review of the appropriateness of costs incurred is required at the end of construction in order to finalise revenue allowances for the project.¹ The Beaully-Denny project has been delayed by a public enquiry and has been subject to additional consenting requirements by both local councils and the Scottish government. As a result, in November 2014, we agreed to provide SP Transmission with additional funding to deliver its work on the Beaully-Denny project. At the same time we agreed to an extension of the construction period for SP Transmission until 2016-17. Following our decision to provide additional funding for SP Transmission's, SHE Transmission sought permission to submit its own request for additional funding on its section of the Beaully-Denny project.

Previous funding decision

Our last funding decision for SHE Transmission's Beaully-Denny project was reached in 2011 following the outcome of the public inquiry². That decision provided for additional funding relating to the impact of certain legislative changes, consenting issues and technical challenges identified during the pre-construction period. It specifically excluded additional costs where we considered that the supporting evidence did not meet the TIRG efficiency criterion. These costs included:

- Uncertain contractor costs

¹ Further detail on the arrangements of the TIRG mechanism can be found in Appendix 1 of this letter

² 19 September 2011 Decision: <https://www.ofgem.gov.uk/sites/default/files/docs/2011/09/beaully-denny-shetl-avae-determination-final.pdf>

- Uncertain land access costs
- Forecast change in foundation types required
- Allowance for small aggregate contract.

Our 2011 decision explained that:

“Should these, or any other costs not included in SHETL’s notice occur, we will reconsider their treatment at the end of project’s construction period as stipulated in the TIRG condition. Any such cost could potentially be included in the post-construction opening asset value if SHETL demonstrate that they were efficiently incurred and if considered beyond the level SHETL is expected to bear in line with the allowed return provided for in the TIRG mechanism.”

Our preferred approach

We consider that it would be best to consider SHE Transmission’s request for additional funding as part of the required expenditure review at the end of construction. This prevents the need to review the request for additional funding during construction, and then carry out a further review at the end of construction. It also allows us to consider the request for additional funding once we have a full understanding of the final costs incurred on the project.

Our review will cover each of the areas referenced in our 2011 decision, as well as any further areas that SHE Transmission puts forward as impacting on the overall cost of the project. Additional funding will only be provided where SHE Transmission is able to show clear evidence that the additional costs meet the criteria for additional funding set out in the TIRG mechanism³. Most importantly, SHE Transmission will need to demonstrate that the additional costs:

- cannot be considered as funded through the risk allowance provided as part of the project’s initial funding
- exceed the level it is expected to bear in line with the allowed return provided for in the TIRG mechanism.

Timing of assessment

In order to allow any changes in allowed revenue and TNUoS charges to take effect from 1 April 2017, we will need to finalise our assessment by late 2016. This will require SHE Transmission to submit the required independent technical report on the delivery of the outputs soon after the line is energised in late 2015. We will review the evidence within this report on an ongoing basis whilst the final reinstatement work within the project is completed. SHE Transmission has told us that all contracts on the project will be let by this point in the project, which should provide confidence on the final cost figure for the majority of elements of the project. However, it is our intention to await final completion of the project and full finalised and audited cost information before finalising our decision. This will require SHE Transmission to submit the relevant reports before the end of September.

Appendix 2 of this letter sets out the timeline we will aim to follow to deliver a decision in time to affect revenues from 1 April 2017. Delivery against this timetable is dependent on receiving the required detailed information from SHE Transmission in a timely fashion.

³ Within the TIRG mechanism, additional project funding can be provided through an Asset Value Adjusting Event (AAVE) under paragraph 3J.6 of condition 3J of SHE Transmission’s special licence condition

Next steps

We will continue our ongoing discussions with SHE Transmission on the exact timings and required level of information within the technical report and audit of costs incurred that they will need to submit as part of their post-construction submission. We expect SHE Transmission to keep stakeholders informed of how it expects the additional funding it is requesting to impact on TNUoS charges.

Should you wish to discuss the issues raised in this document, please contact Thomas Johns at thomas.johns@ofgem.gov.uk or on 020 7901 7046.

Yours Sincerely,

Kersti Berge
Partner, Electricity Transmission

APPENDIX 1: The TIRG Mechanism

The Beaulieu-Denny project is funded under the terms of the Transmission Investment for Renewable Energy mechanism (The TIRG Mechanism). The TIRG mechanism was established in 2004 to fund transmission projects to connect renewable generation outside the price control process to minimise investment delays. It provides the three electricity transmission owners (TOs) with expenditure allowances for specific transmission reinforcement projects.

The various TIRG projects, including the Beaulieu-Denny, can be broken down into four distinct phases:

Pre-construction	Construction	Post-Construction⁴ period	Regulated Asset Value period⁵
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

At the end of construction on each TIRG project, we are required to review the costs incurred and set each project's OAV. This OAV sets the revenue for the post-construction period, which is designed to start the year after a project is commissioned.

⁴ In the licence this term is referred to as the 'incentive period'

APPENDIX 2: SHE Transmission Beaulieu-Denny project: proposed submission and review timeline

