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Head of RIIO ED1
Ofgem
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Dear Grant,

CRC 3F - Arrangements for the recovery of uncertain costs: subsea cable costs (UCSC)

Dear Grant,

The purpose of this letter is for Scottish Hydro Electric Power Distribution Plc (SHEPD) to formally request the deferral of the Subsea cable uncertainty window as provided under our licence condition, CRC3.F.11(a). We have been very grateful for the ongoing dialogue between Ofgem, Marine Scotland and SHEPD which has facilitated the development of our subsea cable risk based assessment tool. This resource will play a crucial role in informing our applications for marine licences and the Marine Scotland consultation process which will follow. We hope this approach will lead us to the best outcome for all parties and most importantly, the consumer.

The following short sections outline the rationale for our request to defer the uncertainty window. We would also take this opportunity to reference the primary documents created so far by the submarine cable consultation programme. These can be found online at: <http://news.ssepd.co.uk/submarinecables/>

Introduction of subsea cable uncertainty mechanism

During the later stages of the RIIO-ED1 price control process (2014) it became apparent that the developing National Marine Plan for Scotland could increase cable protection obligations for marine network users. Such alternative installation solutions would in turn materially increase the cost of replacing such assets. Prior to this point all recent cable investment had been permitted by standard surface (sea bed) lay techniques.

This therefore introduced the potential that in adhering to such protection obligations our proposed ED1 marine cable replacement programme would face a material increase in expenditure. There was also insufficient clarity over the circumstances in which protection solutions would be required. Hence, the volume of each protection method within our ED1 programme (the mix) could not be forecast with any certainty. Furthermore, the absence of previous distribution network infrastructure protection schemes prevented the use of benchmark unit rates.

The combination of an uncertain workload mix coupled with limited reference points for cost efficiency assessment rendered the calculation of ex-ante alternative SHEPD subsea cable Totex allowances impossible. Hence, this necessitated the inclusion of an uncertainty mechanism in the RIIO-ED1 licence. Following dialogue, both Ofgem and SHEPD also recognised that until the causes of expenditure uncertainty could be eliminated, a revised expenditure allowance could not be calculated. For this reason the licence also allowed for the deferral of the mechanism window until such time as appropriate.

Progress to date

Both Ofgem and SHEPD identified early on that to reduce the uncertainty over what volume of enhanced protection would be required for our replacement programme a robust risk based assessment solution was necessary. Since early 2015 SHEPD has been actively developing a risk assessment tool, based on Cost Benefit Analysis (CBA) techniques, which will evaluate the appropriate protection method for each cable installation.

Our CBA tool has been developed with the advice and support of AECOM and in conjunction with a wide range of marine stakeholders. The model has been informed by the responses of multiple public consultations and based upon, we believe, the key factors which inform the risk assessment decision. We will publish a final report covering the development of our CBA model and methodology in late March / early April 2016. The accompanying CBA model will represent the baseline version for initial RIIO-ED1 licence applications.

We are preparing to test this tool further by commissioning a quality review by an expert third party. Following this we will begin the process of assessing the justification for additional protection across an initial project sample taken from our replacement programme, prior to submitting licence applications for these assets to Marine Scotland.

Remaining uncertainty

Testing the application of our CBA tool across a proportion of our cable population is an essential step in the process of understanding and reducing the Totex uncertainty. We propose to achieve this by applying for c. 8 marine licences, commencing in spring 2016. Our hope is this test will identify to

what extent the conclusions of each CBA will inform the final Marine Scotland licence. This in turn will allow us to assess what level of reliance we can place on the CBA and its conclusions to inform the forecast of the remaining RIIO-ED1 totex requirements.

The licence application review process will take a number of months and may require extended dialogue with all interested marine stakeholders in light of the conclusions of the CBA. Until this process is complete and we have a robust basis on which to forecast the protection requirements for the remaining population and for the remainder of RIIO-ED1 we will not be in a position to apply to the Authority under condition CRC 3F for amended Totex allowances. We also recognise that the opportunity to incorporate cost efficiency evidence from actual cable protection schemes would be of value in a future uncertainty mechanism application. This information will become available in the year following the Marine Scotland licence award, 2017, as we undertake the replacement projects.

Proposal to defer subsea cable uncertainty application window

Therefore, to provide sufficient time to conclude the licence application process and to enable reference to actual cable replacement projects we conclude that the uncertainty application window should be deferred until at least 1-31 May 2018. We also recognise that if by early 2018 uncertainty remains over which protection solutions will be required across future replacement projects remains we will request that Ofgem reconsider the suitability of the uncertainty provision.

Please do not hesitate to contact me if you wish to discuss any of the points raised in this letter further.

Yours sincerely

Michael Ferguson
Networks Regulation Manager