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Your ref

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Date

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Contact / Extension

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Dear Neill

Direction under paragraph 2L.13 of Special Condition 2L (methodology for Network Output Measures) of the electricity transmission licence.

SP Transmission plc (SPT) is the electricity Transmission Network owner in central Scotland. The transmission network consists of the extra high voltage infrastructure that conveys electricity from power stations and interconnectors to distribution system entry points or, in certain cases, direct to end users' premises.

The design and development of the transmission system is significant in its importance to delivering security of supply and reflects the economic tests inherent in the industry's standards. We are committed to maintaining a high quality of service to consumers in an economic, efficient and co-ordinated manner and as such, welcome the opportunity to contribute to the current consultation in relation to the above draft Direction.

Background

In conjunction with the two other transmission licensees, we have worked collaboratively with Ofgem throughout 2015 to develop the joint Networks Output Measures (NOMs) methodology in line with the principles agreed in February 2015. This development work progressed with agreement from all parties, and stakeholder engagement events were held in late October and early November 2015, gaining positive feedback on the methodology and generating constructive suggestions for further enhancement. In mid-November 2015 new feedback was received from Ofgem laying out their view that further work was necessary to fully meet the requirements of the NOMs objectives and comply with the principles. The Transmission companies have responded to this feedback and submitted a joint revised methodology in February 2016 which we believe reflects the revised scope and work agreed with Ofgem at that time.

Draft Direction

We believe that the draft Direction goes beyond the scope of the agreed NOMs principles. For example, the introduction of the concept of "Condition Risk"; the suggestion that output targets in RIIOT1 could be modified based on the revised methodology, and the risk of reducing asset management planning to an overly quantitative process; and introducing changes to maintenance programmes as a mechanism to justify changes to health indices or asset lives. I have addressed each of these areas in turn in the attached appendix.

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In order to address the above challenges, we are committed to work further with our transmission licensee colleagues and to engage with Ofgem in the development of the Transmission Network Output Measures Methodology. The working group is progressing elements of this draft Direction and have developed the work plan we have agreed with Ofgem, which we shall extend to incorporate the new requirements of the draft direction. We have already involved additional specialists in asset risk, criticality and other subject matter experts in each asset category to the workstreams that form part of the development plan to ensure that the methodology aligns with the agreed principles. We will also carry out further formal engagement with our stakeholders to ensure that their views on the methodology are taken into account.

We want to be entirely clear that we are supportive of the development of the methodology to form the basis of future price control targets, but that it is not appropriate to apply the revised methodology to reset our RIIO-T1 targets. Our investment plan is on course to deliver our non-load strategy and meet the outputs of our RIIO-T1 agreement. We would therefore be grateful for confirmation that the existing target outputs will not retrospectively be amended in the transmission licence in line with the principles of 'Better Regulation'.¹

We recognise that the requirements of the draft Direction are a significant task to deliver. In order to achieve the work in the timescales, we look forward to receiving feedback from Ofgem throughout the process to ensure that the work that the Transmission Licensees are undertaking aligns with its expectations.

Yours sincerely,

Eric Leavy
Head of Transmission Network
SP Energy Networks

¹ <https://www.gov.uk/guidance/better-regulation-and-the-regulators-code>

1. transparent
2. accountable
3. proportionate
4. consistent
5. targeted (only at cases where action is needed)

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2. Extent of Modification

A. Common Methodology

General Extent of Modification

1. Paragraph 9 (Page 8 of Draft Direction)

The provisions of Special Licence Conditions 2L and 2M are expressed in terms of Replacement Priority only - therefore monetisation does not currently apply. However, Monetisation, or another suitable Common Currency, is the agreed approach for the development of the Methodology and is contained in the current version (February 2016) of the Methodology document.

2. Paragraph 9a (Page 8 of Draft Direction)

The draft direction introduces for the first time the concept of Condition Risk. This concept is not defined in the licence and none of the NOMs are expressed in these terms. In addition, the definition in Annex 3 would benefit from further development as it is necessary to differentiate Condition Risk from other types of risk. Clarification of how this new concept aligns with the licensees' licence conditions, including the definition of the NOMs, is required. We suggest that the definition should be developed in the methodology working group such that it can be captured in the methodology document and subsequently included in the Regulatory Instructions and Guidance if necessary.

3. Paragraph 9b (Page 8 of Draft Direction)

Changes in a Common Currency risk score due to an intervention and the cost of that intervention are not equivalent across asset types and direct linkage between the two could lead to unintended distortion of the mechanism. As an example, if the cost per unit of Common Currency risk reduction for switchgear was less than that for transformers, a simplistic measure of efficiency would disincentivise investment in transformers.

However, individual assets cannot be assessed in isolation but must be considered as constituent parts of the broader network. We are concerned that the monetisation approach could lead to sub-optimal investment decisions if it does not incorporate an understanding of the significance of components and assets in the design of the network. Ensuring that the interdependency of assets is recognised is essential to the production of a balanced investment plan.

The monetisation approach that is developed must take into account the impact on future investment plans. Undue focus on assets with the lowest cost per unit of risk reduction in early plans will require investments in assets with higher costs per unit of risk reduction in later periods. This type of approach will not deliver the required reduction in real network risk at the required time due to the failure to treat the assets in a systematic manner which reflects how they are configured on the network.

Our engagement in the development of the methodology going forward, will seek to ensure that the interdependency of asset types and the linkages between consequences of failure of different asset types is captured effectively to continue to maximise the effectiveness of the risk reduction of our intervention plans.

4. Paragraph 20 (Page 10 of Draft Direction)

In line with the agreed definition of interventions, we agree maintenance should be defined in the current methodology as activities which, when carried out in accordance with the manufacturer's recommendations and with the manufacturer's recommended frequency will only result in the asset achieving its design life and ensure the asset's performance. Compliance with routine maintenance activities is assumed within the calculation of the asset's health index and will not extend asset life. Refurbishment interventions however, will improve the asset condition or result in an extension of asset life. The type and frequency of maintenance will be modified by, for example, the asset's duty and location in order that the asset will achieve its design life.

It is therefore unclear how the methodology will develop a mechanism to justify changes to maintenance programmes or trade-offs between Opex and Capex investment as proposed in the final sentence of this paragraph. This appears to be a new concept for the methodology and further clarity on how this links to the Objectives is essential.

Asset Criticality

5. Paragraph 21 (Page 10 of Draft Direction)

In addition to the comments made on paragraph 9a, it is re-iterated that the NOMs as defined in the licence do not refer to Condition risk. We would be grateful if Ofgem could consider our proposal for clarification on this matter as detailed in our comments on paragraph 9a.

6. Paragraph 22 (Page 10 of Draft Direction)

The development of the criticality methodology, as specified in this paragraph, should take into account the availability of historic data given the relatively small populations and failure rates of transmission assets. The large number of permutations of potential future scenarios and the relative scarcity of historic data requires careful consideration of the optimum set of scenarios to produce reliable outputs.

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We would like to clarify the concept of redundancy as expressed in 22 a. The transmission system is designed in accordance with the Security and Quality of Supply Standard (SQSS). The standard has been developed and assessed such that it defines the minimum requirements for security and has incorporated economic tests to arrive at a coordinated set of criteria and methodologies resulting in a system which is economic, efficient and operable. The standard does not dictate redundancy, rather it sets out the characteristics of the system necessary to meet the required levels of security.

Effective evaluation of network risk in the transmission system needs to be built on these principles and not seek to redefine them.

Network Replacement Output Targets

7. Paragraph 29 (Page 11 of Draft Direction)

Confirmation would be helpful such that, for the avoidance of doubt, the Network Replacement Outputs targets set out in Licence Special Condition 2M will not be restated as a result of the translation to Common Currency values and that the provision of paragraph 27 (future price control period) applies.

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