

Email: RIIO.ED1@ofgem.gov.uk

Date: 9 March 2018

Dear colleague,

Direction to defer the application window in respect of the Subsea Cable Costs uncertainty mechanism for Scottish Hydro Electric Power Distribution Plc under Charge Restriction Condition 3F.11(a) of its electricity distribution licence

On 6 October 2017, Scottish Hydro Electric Power Distribution Plc (SHEPD) submitted a request to the Authority,¹ as set out in the consultation published 1 February 2018,² seeking a deferral of the Subsea Cable Costs uncertainty mechanism application window from the current application window of 1 May-31 May 2018³ to 1 February-28 February 2019.

This letter explains the background to SHEPD's request and sets out our decision to direct a new application window of 1 February-28 February 2019, or such later dates as directed by us.

Background

In 2015, Marine Scotland published the National Marine Plan,⁴ which provides a framework for all marine activities in Scottish waters, including how subsea electricity cables are laid and protected on the seabed. The National Marine Plan states that subsea cables should be buried to maximise protection, unless it can be demonstrated that burial is not a feasible option. In these cases, cables should be suitably protected "where practicable and cost-effective and as risk assessment directs".

SHEPD has 111 subsea cables, 110 of which are surface lay (i.e. are not protected). As part of the RIIO-ED1⁵ settlement, we have funded SHEPD to replace c.85km of these subsea cables on a risk-based approach. However, this allowance does not cover costs relating to the protection of subsea cables under the National Marine Plan. Because protection costs were uncertain at the time we set the price control, we included an uncertainty mechanism, enabling SHEPD to apply for additional funding to cover the costs of any cable protection required in order to comply with the National Marine Plan.

¹ References to the "Authority", "Ofgem" "we" and "our" are used interchangeably in this document to refer to GEMA, the Gas and Electricity Markets Authority. The Office of Gas and Electricity Markets (Ofgem) supports GEMA in its day to day work.

² https://www.ofgem.gov.uk/system/files/docs/2018/02/subsea_application_window_consultation_2.pdf

³ As provided for under Charge Restriction Condition (CRC) 3F.11(a) of its electricity distribution licence and a previous Direction <https://www.ofgem.gov.uk/publications-and-updates/riio-ed1-direction-defer-application-window-shepd-subsea-cables-costs-uncertainty-mechanism>.

⁴ <http://www.gov.scot/Publications/2015/03/6517>

⁵ RIIO-ED1 is the current electricity distribution price control which runs from 1 April 2015 to 31 March 2023. For more information, please see the RIIO-ED1 infographic available on our [website](#).

SHEPD's request

Since 2015, SHEPD has been developing a risk assessment tool (based on Cost Benefit Analysis (CBA) techniques) to understand if it needs to change its engineering practices to meet the requirements of Scotland's National Marine Plan, in terms of how subsea electricity cables are installed on the seabed.⁶

In its previous application for deferral of the application window (from 1 May-31 May 2016 to 1 May-31 May 2018), SHEPD explained that deferring the Subsea Cable Costs uncertainty application window to May 2018 would give it the time needed to:

- test the CBA model on eight subsea cables during the marine licence application process with Marine Scotland⁷, commencing in spring 2016 and possibly requiring extended dialogue with all interested marine stakeholders;
- assess what level of reliance it can place on the CBA and its conclusions to inform its cost forecasts; and
- incorporate evidence of cost efficiency from actual cable replacement projects from the year following the Marine Scotland licence award (2017).

This was intended to reduce the uncertainty in SHEPD's application to Ofgem for additional funding. However, if uncertainty remained, SHEPD stated that it would be likely to apply to Ofgem to reconsider the suitability of the uncertainty provision.

SHEPD notes in its current deferral application (to move the application window from 1 May-31 May 2018 to 1 February-28 February 2019) that progress has been made since the previous deferral application. Notably, the CBA has been through a number of iterations in collaboration with Marine Scotland. In addition, SHEPD has been granted its first Marine Licence to replace the 10.4km Rousay – Westray cable, which was supported by the output of the CBA⁸. However, due to the ongoing development of the CBA, fewer than anticipated replacement projects have reached licence award and subsequent delivery stage. As such, uncertainty remains. SHEPD notes that:

- this has limited its ability to accurately forecast the level of protection that will be required by Marine Scotland over the remaining RIIO-ED1 cable programme; and
- this would not satisfy the requirements of the uncertainty mechanism or provide assurances that future protection costs could be sufficiently justified and therefore recovered through revised RIIO-ED1 allowances.

SHEPD expects there will be a steady stream of applications under the National Marine Plan in the coming 12-14 months which, in addition to the extended seabed survey programme, will provide it with the necessary evidence and information by the end of 2018 to forecast the incremental protection costs arising from Marine Scotland's licensing decisions.

⁶ <http://news.ssepd.co.uk/submarine-cables/>

⁷ Certain activities require a marine licence before they can be carried out in Scotland's seas, including how subsea electricity cables are laid and protected on the seabed. Decisions on marine licensing are taken in accordance with the Scottish National Marine Plan and marine licences are issued by Marine Scotland on behalf of the Scottish Ministers.

⁸ <http://news.ssen.co.uk/news/all-articles/2018/january/rousay-westray-cable-replacement-given-go-ahead/>

Our decision

We have considered SHEPD's request and the one response we received (from SHEPD) to the consultation. The response⁹ supports the minded-to position adopted by Ofgem and the rationale for deferring the application window.

In view of the points raised by SHEPD in its request and its consultation response, and in accordance with our principal objective and statutory duties, we consider it appropriate to agree to its request and defer the uncertainty mechanism application window for Subsea Cable Costs under CRC 3F.11(a) to a **window that opens on 1 February 2019 and closes on 28 February 2019, or such later dates as directed by Ofgem.**

The Authority considers this to be an appropriate amount of time for SHEPD to fully test and deploy the CBA tool and to incorporate into their uncertainty mechanism application evidence of expenditure and cost efficiency from actual built-out cable replacement projects.

Direction

Attached as an Annex to this letter is a formal Direction deferring the application window for SHEPD's Subsea Cable Costs uncertainty mechanism to a window that opens on 1 February 2019 and closes on 28 February 2019, or such later dates as directed by Ofgem.

Yours faithfully,

Steven McMahon
Associate Partner RIIO Networks, Electricity

⁹ <https://www.ofgem.gov.uk/publications-and-updates/riio-ed1-consultation-second-deferral-application-window-shepd-subsea-cables-costs-uncertainty-mechanism>

Annex

DIRECTION PURSUANT TO CHARGE RESTRICTION CONDITION 3F.11(A) OF SCOTTISH HYDRO ELECTRIC POWER DISTRIBUTION PLC'S ELECTRICITY DISTRIBUTION LICENCE IN RELATION TO THE DEFERRAL OF THE APPLICATION WINDOW FOR THE SUBSEA CABLE COSTS UNCERTAINTY MECHANISM

Whereas:

1. Scottish Hydro Electric Power Distribution Plc (SHEPD) is the holder of an electricity distribution licence treated as granted under section 6(1)(c) of the Electricity Act 1989.
2. In Charge Restriction Condition (CRC) 3F 'Arrangements for the recovery of uncertain costs', the Authority outlines the process that SHEPD should follow in order to apply for a relevant adjustment to the allowed levels of expenditure for uncertain cost activities, including Subsea Cable Costs.
3. CRC 3F.11(a) states that in respect of Subsea Cable Costs, SHEPD may only give Notice of a proposed change to an allowed level of expenditure during a window that opens on 1 May 2016 and closes on 31 May 2016, or such later dates as directed by Ofgem.
4. On 4 March 2016, SHEPD requested, and the Authority subsequently directed, a deferral of the Subsea Cable Costs uncertainty mechanism application window from the then application window of 1 May-31 May 2016 to 1 May-31 May 2018, or such later dates as directed by Ofgem.
5. On 6 October 2017, SHEPD submitted another request to the Authority, seeking a further deferral of the Subsea Cable Costs uncertainty mechanism application window to 1 February-28 February 2019.
6. The Authority has considered SHEPD's request and has decided to defer the uncertainty mechanism application window for Subsea Cable Costs under CRC 3F.11(a) to a window that opens on 1 February 2019 and closes on 28 February 2019, or such later dates as directed by Ofgem. The Authority considers this to be an appropriate amount of time for SHEPD to fully test and deploy the CBA tool and to incorporate into their uncertainty mechanism application evidence of expenditure and cost efficiency from actual built out cable replacement projects.

Therefore:

In accordance with CRC 3F.11(a), the Authority hereby directs that in respect of Subsea Cable Costs, SHEPD may only give Notice of a proposed change to an allowed level of expenditure during a window that opens on 1 February 2019 and closes on 28 February 2019, or such later dates as directed by Ofgem.

This Direction will have effect on and from the date of publication.

This document constitutes notice of the reasons for the decision to issue the direction pursuant to CRC 3F.11(a) as required by section 49A of the Electricity Act 1989.

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Steven McMahon
Associate Partner RIIO Networks, Electricity
Duly Authorised on Behalf of the Gas and Electricity Markets Authority
9 March 2018