

To interested parties

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Dear Colleagues,

Decision for Statutory Consultation on proposed modifications to the ED1 Price Control Financial Instruments to implement the decision on Scottish Hydro Electric Power Distribution's allowed costs for the Shetland Extended Interim Energy Solution

On 25th July 2019, we published a Statutory Consultation¹ on proposed modifications to the RIIO-ED1 Price Control Financial Instruments.² The proposed modifications would give effect to our decision on allowed costs for Scottish Hydro Electric Power Distribution (SHEPD) relating to the Shetland Extended Interim Energy Solution.

We proposed to modify the ED1 Price Control Financial Model (PCFM) and the ED1 Price Control Financial Handbook (Financial Handbook) to align them with the recently modified Electricity Distribution Licence by including three new licence terms, UCSEFEC, UCSESPC and UCSEBC, and their relevant ex-ante cost allowances.

Effect of modifications

The introduction of the three new licence terms, UCSEFEC, UCSESPC and UCSEBC, in the PCFM and Financial Handbook would enable SHEPD to recover the ex-ante cost allowances that we have decided to allow them in relation to these three terms and would further ensure that the Price Control Financial Instruments are in line with the licence.

The sum of the opening level of allowed expenditure for all three of the new Variable Values is £85.4 million, as outlined in the consultation. Based on the calculations in the PCFM, an increase in SHEPD's variant cost allowances of £85.4 million would have an estimated allowed revenue impact of £24.1 million over the final four years of the RIIO-ED1 price control.

This increase in allowed revenue for SHEPD would flow through automatically as part of the MODt term for 2020/21, which will be determined in November each year following the Annual Iteration Process for the last four years of the price control. Including these terms within the PCFM will allow us to assess these cost allowances on an annual basis and adjust SHEPD's allowed revenue as required.

¹ <https://www.ofgem.gov.uk/publications-and-updates/statutory-consultation-modify-riio-ed1-price-control-financial-instruments-shetland-extended-interim-energy-solution-costs>

² As defined in CRC 1B (Interpretation of Part 4): the ED1 Price Control Financial Handbook (which contains the ED1 Price Control Financial Methodologies) and the ED1 Price Control Financial Model.

Summary of consultation response

We received one response to the consultation from SHEPD, which has been published on our website alongside the original consultation and summarised at Appendix 1 to this letter.

In their response, SHEPD agreed that the proposed modifications to the ED1 PCFM and Financial Handbook are necessary to implement the Shetland Extended Interim Energy Solution Costs decision.

SHEPD proposed a number of minor amendments to the ED1 Financial Handbook drafting, which we have considered and decided to accept. These changes are set out in SHEP's response. We have decided to implement these proposed changes because they ensure clarity and consistency of style between the sections of the Financial Handbook. Otherwise, the proposed changes do not have a material impact. Please see Appendix 1 for more detail.

In its response, SHEPD additionally expressed concern over the capitalisation rate used in the PCFM noting that it seeks timely consultation and determination on a modification of this rate.

We note that this capitalisation rate is a part of SHEPD's Electricity Distribution Licence and that to undertake a PCFM or Handbook modification, we must first modify the licence for any change. This change was not proposed by SHEPD in our most recently held consultation on changes to the Electricity Distribution Licence³ and would therefore require a separate Statutory Consultation. We are currently engaging with SHEPD in this respect.

Any modification to the rate in the ED1 PCFM and ED1 Financial Handbook would take place following a change to the Licence.

Our decision

Having carefully considered the response received to our statutory consultation, we have decided to proceed with the modifications to the ED1 PCFM and Financial Handbook as proposed in our consultation and to additionally reflect the minor amendments suggested by SHEPD in its consultation response for the reasons set out above.

Next steps

We have published the revised ED1 PCFM, the ED1 Financial Handbook and the associated decision notice on our website, in the appendices alongside this decision. These modifications will come into effect on 2nd November 2019, 56 days after publication of this decision.

If you have any questions on this letter, please contact penny.harandy@ofgem.gov.uk.

Yours sincerely,



Steven McMahon
Deputy Director, Electricity Distribution and Cross Sector Policy

³ https://www.ofgem.gov.uk/system/files/docs/2018/06/supplementary_annex_1_-_shetland_licence_drafting_final.pdf

Appendix 1

PROPOSED MINOR LICENCE AMENDMENTS

Financial Handbook paragraph reference	Proposed amendment	Ofgem response
7.99	<i>"The uncertainty mechanisms s provides for relevant adjustments to levels of allowed expenditure for [both this cost terms for] Regulatory Year 2019/20 to Regulatory Year 2022/23"</i>	Amendments accepted, this section relates to a single uncertainty mechanism.
7.112	To include the following in the drafting: <i>"... in implementing its obligations under CRC 2Q and further to the competitive process referred to in the Authority's open letter entitled "Ofgem's determination of Scottish Hydro Electric Power Distribution plc's (SHEPD) submission required under Charge Restriction Condition (CRC) 18A" dated 22 April 2014, to the extent that those costs are not otherwise recoverable under the Charge Restriction Conditions of the ED1 licence."</i>	Amendment accepted, this section is consistent with the Close-out methodology drafting and should be included in the Handbook drafting.
7.113	<i>"The uncertainty mechanisms provide for relevant adjustments to levels of allowed expenditure for both cost terms for Regulatory Year 2019/20 to Regulatory Year 2022/23 in respect of: a. efficient costs that were not included in the calculation of Opening Base Revenue Allowances for SSEH (with respect to proposals made by SSEH); and b. Shetland Enduring Solution Process Costs that are materially lower or higher than expected levels of actual expenditure (with respect to proposals made by the Authority or SSEH)."</i>	Amendment accepted, this is consistent with the equivalent paragraphs in Sections 7.10 and 7.12.
7.125	We suggest paragraph 7.125 should refer to Section 12 of the Handbook.	Amendment not accepted. Paragraph 7.125 currently references Section 7.12 of the Handbook (<i>Methodology for determining relevant adjustments in respect of Shetland Extension Battery Costs (SSEH only)</i>). Section 7.12 is a subsection of section 7, whereas Section 12 relates to the financial adjustment methodology for the IRM mechanism.
7.126	<i>"CRC 3F sets out a mechanism for revising SSEH's allowed level of Shetland Extension Battery Costs (UCSEBC) expenditure at the end of the price control period. CRC 3F.13 provides the application windows for</i>	Amendment accepted – grammatical edit.

	<i>the licensee to propose adjustments in respect of UCSEBC.”</i>	
Table 7.2	Column 3 may be missing the following word in red: <i>“Relevant licence condition”</i>	Amendment accepted.