Network Planning & Regulation

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Dear James

Consultation on assessment of capital costs for the Hinkley-Seabank electricity transmission project

This response is from SP Transmission (SPT), the onshore transmission owner (TO) for the South of Scotland. As a TO, we have a duty to ensure that we develop and maintain an economic, efficient and coordinated onshore transmission system. We therefore welcome the opportunity to share our views on the assessment of capital costs for National Grid Electricity Transmission's (NGET) Hinkley-Seabank (HSB) project.

We welcome Ofgem's decision to propose funding delivery of HSB through the Strategic Wider Works (SWW) mechanism, rather than through the CPM. In the case of HSB, Ofgem *"do not consider that there is clear evidence in this case that applying the CPM (and therefore departing from the existing SWW arrangements under RIIO) is in the interest of consumers*[1]*"*. We agree with Ofgem that SWW is the right delivery framework for this important, strategic infrastructure.

We share our views on the consultation questions below:

Q1. Regarding T-Pylons, do you agree with our initial views in relation to:

a) NGET's approach to proposing T-Pylons in its planning application?

b) Disallowing £11.3m of T-Pylon 'development costs'?

c) Allowing £12.3m of additional costs for T-Pylons along the route?

Whilst we are not best placed to offer comment on the specific costs of the use of T-Pylons in this project, we do think Ofgem's decision to remove £11.3m of costs in relation to the development of the T-Pylons does have a read across, in general, to the funding and development of innovation in transmission network projects.

Ofgem's position is that *"NGET could have sought funding for these costs under the RIIO-T1 mechanisms aimed at delivering innovation (or the mechanisms in TPCR4, the price control preceding RIIO-T1. We do not think it is appropriate to use the SWW framework to fund innovation spend and bypass the governance we put in place related to innovation. Nor do we consider it appropriate to use project-specific allowances to fund innovation that may be utilised elsewhere on the network".*

1 Ofgem (October 2019), Hinkley-Seabank: Consultation on our updated delivery (p33)

Ofgem's approach does not appear to recognise that an important element of the development of innovation is taking the opportunity when it arises – as it appears NGET have done in this particular instance. There may often be opportunities in the design and development of large scale infrastructure for innovation. This should be encouraged. Such innovation could offer potential benefits both for the project in question, and also for future projects and customers alike in the longer term. However, Ofgem, here, appears to be implying that innovation can only take place and be supported, in particular forums, namely through Ofgem's own Network Innovation Competition (NIC) and Network Innovation Assessment (NIA) type schemes in order to ensure appropriate governance regimes are in place. Separating the need, from the innovation opportunity will essentially be a blocker to new technologies and methodologies being adopted across the transmission network.

We also question whether this approach to innovation is consistent with Ofgem's wider policy, which we understand is to encourage innovation across TO businesses as "business as usual".

We would be disappointed if this decision set a precedent for future large infrastructure projects whereby they couldn't support the introduction of new/innovative transmission infrastructure that could be replicated elsewhere, with the potential to benefit future projects and reduce costs for consumers.

2. Do you agree with our proposals on how to treat high impact, low probability and difficult to quantify risks?

We are concerned with Ofgem's proposals for the treatment of High Impact, Low Probability (HILP) risks and the precedent it could set for other large transmission projects in the future. Ofgem's current proposal means that there is no immediate means for NGET to be funded for dealing with HILP risks until the 10% threshold is met, resulting in NGET potentially accumulating a significant overspend. Ofgem states in this consultation that, *"We are minded to allow capital costs of £637.0m for the delivery of HSB which constitutes a reduction to NGET's submitted costs of £79.8m (11%)*"[2]. This is a significant financial burden for NGET to carry. This will be the same scenario for TOs developing large transmission projects in the future, given the significant costs involved in delivering such infrastructure

Ofgem's proposals for the Cost and Output Adjust Event (COAE) is changing the purpose of the COAE in transmission regulation. The purpose of the COAE mechanism is to account for events which are low probability in their nature, i.e. extreme weather events. Therefore the COAE is only likely to be used in a limited number of occasions during the construction and operation of a significant transmission asset. However, the additional risks proposed by Ofgem in Appendix 2 of this consultation includes events which we do not consider are low probability for the HSB project, such as protestor action, given the nature of this particular project. Ofgem's proposals will result in the COAE being utilised repeatedly to account for costs, of which there will be many, for a series of risks, given the scale and nature of this significant infrastructure project. In addition, it will be at Ofgem's discretion as to whether to allow the COAE mechanism to be used, following NGET's request. This in itself is another risk which NGET have to bear.

In our view, the revisions to the COAE are attempting to address a remnant of the intended CPM delivery mechanism whereby the CPM framework allowed for a Post Construction Review (PCR) period whereby the PCR would *"assess whether any qualifying risks from the PA have eventuated,*

[2] Ofgem (October 2019), Consultation on our assessment of capital costs for the Hinkley-Seabank electricity transmission project (p4)

and, if so, establish the efficient levels of funding under the terms of the CPM (the costs associated with these risks will not be subject to the sharing factor)[3];".

Ofgem's proposed approach is to not fund any mitigation works undertaken by the TO's to mitigate against identified risks. In taking this approach, there is a greater risk that a significant event could occur due to a lack of ability by the TO to mitigate the risks it identifies. Rather than adopt an 'insurance will pay out' approach as is suggested by Ofgem here, we consider it prudent, and a more effective use of consumers' money, to fund activities that will either eliminate or minimise significant risk, such as severe weather events, in the first instance. We would argue the approach proposed here is inconsistent with well-practised industry-wide risk management practices.

This is an issue that needs to be resolved for the HSB project but also for other future large scale transmission projects. In our view, as suggested above, we believe it is in consumers' best interests that TOs are funded to deal with risks, on an ex ante basis, to manage potential risks in the first instance.

3. Do you have any views on our proposed treatment of other costs not covered in questions 1 and 2?

We have no further comments to offer.

Please do not hesitate to get in touch should you wish to discuss any of the points raised in this consultation response.

Yours sincerely

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[3] Ofgem (September 2018), Further Update on CPM

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