Making a positive difference
for energy consumers

To all interested stakeholders

Email: NTImailbox@ofgem.gov.uk

Date: 30 July 2020

Dear stakeholders,

Confirmation of approval of SHEPD proposal to contribute to the Shetland electricity transmission project

In December 2019 we published our decision on Scottish Hydro Electricity Power Distribution's (SHEPD) proposal to contribute financially towards Scottish Hydro Electricity Transmission's (SHE-T) proposed transmission links to Shetland, Orkney and Western Isles. In this decision we explained that if we approved the Final Needs Case for Shetland transmission project, we would approve SHEPD's contribution proposal, subject to the proposal being implemented appropriately[1]. We have now approved the Final Needs Case for the Shetland transmission project[2] and are now confirming our approval of the contribution proposal.

We are approving SHEPD's contribution proposal because we consider it is being implemented appropriately. Our December 2019 decision explained that we expected the implementation would involve modifications to the Connection and Use of system Code (CUSC) to allow the contribution to be transparently reflected in generator charges and eventual licence modifications to allow the contribution to be transferred from SHEPD to SHE-T. We have recently approved Charge Modification Proposal (CMP) 337 and 338 to the CUSC[3]. These modifications allow for a reduction equivalent to SHEPD's contribution towards the Shetland link, to flow into the associated TNUoS charges faced by generators. As referenced in the Next Steps section later in this letter, we expect to work with the relevant licensees to develop the required licence changes from this summer.

[1] https://www.ofgem.gov.uk/system/files/docs/2019/12/20191217_shepd_contribution_decision_accessible.pdf
[2] www.ofgem.gov.uk/publications-and-updates/shetland-transmission-project-decision-final-needs-case-and-delivery-model
[3] https://www.ofgem.gov.uk/publications-and-updates/cmp337-and-cmp338-decision

For reference, a summary of the approved methodology for setting the contribution value is provided in Appendix 1.

Next Steps

As referred to in our December 2019 Decision, having approved the contribution methodology proposal in that document, we will set the level of the contribution following completion of our Project Assessment for the Shetland transmission project. Specifically, we will update the Capacity Support aspect of the contribution, which is set at 17.4% of the final value of the link.

We will undertake a Project Assessment of the Shetland transmission project from summer 2020 to determine SHE-T's permitted costs for delivery of the Shetland transmission project. The Project Assessment is the process through which the cost allowances for the transmission link will be assessed, consulted and then finalised by us.

We expect to start the process of finalising the changes needed to the SHEPD and SHE-T licences with both licensees in parallel to our work on the Project Assessment.

Appendix 1 – The approved methodology for setting the contribution value for the Shetland project

The contribution is built up from three types of benefit that SHEPD and its consumers will benefit from.

1. **Capacity Support:** Once Lerwick Power Station is decommissioned, demand supplies on the island would need to be secured through alternative means. Based on its analysis SHEPD expects that, if SHE-T's proposed 600MW cable link is approved, for 17.4% of the time, supply on the island would need to be directly supported by imports via the transmission link. It has therefore calculated that the value of this benefit should be quantified at 17.4% of the final value of the link. The value of this benefit would therefore be determined by the final cost of proposed transmission link. SHE-T's original cost estimates for the 600MW link was £709m, meaning that the contribution from SHEPD customers would be £123m. As referenced in our April 2020 FNC consultation, the cost estimate for the link has been reduced to £630m; meaning that the value of the contribution would be **£110m.**

2. **Control support:** Alongside network capacity, existing generation arrangements on Shetland also currently regulate system stability on the Shetland distribution system. Replacement of these with an HVDC transmission cable link will provide additional benefits to the distribution system. An HVDC converter station on the island would allow for network stability to be managed in a more efficient way, by allowing more intermittent renewable generation to replace the traditional thermal generation currently carrying out this service. Under the contribution methodology for the Shetland electricity transmission project, the indicative value of this benefit is quantified at **£117.5m.**

3. **Losses reduction:** The solving of the demand issue using a higher voltage transmission solution would reduce the level of electrical losses relative to a comparable distribution solution. Under the contribution methodology for the Shetland electricity transmission project, the value of this impact is quantified at **£10.2m.**