

Email: RIIO.ED1@ofgem.gov.uk

Date: 16 May 2016

Dear colleague,

Direction to defer the application window in respect of 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 4 March 2016, SHEPD submitted a request to the Authority,¹ as set out in the consultation published 12 April 2016,² seeking a deferral of the Subsea Cable Costs uncertainty mechanism application window from the current application window of 1 May to 31 May 2016³ to 1 May to 31 May 2018, or later.

This letter explains the background to SHEPD's request and sets out our decision to direct a new application window between 1 May 2018 and 31 May 2018, 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 submarine 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 have 111 subsea cables, 110 of which are surface lay (ie are not protected). As part of the RIIO-ED1⁵ settlement, we have funded SHEPD for the replacement of 36 of these subsea cables. 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

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/publications-and-updates/riio-ed1-consultation-deferral-application-window-shepd-subsea-cables-costs-uncertainty-mechanism>

³ as provided for under Charge Restriction Condition (CRC) 3F.11(a) of its electricity distribution licence.

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](http://www.ofgem.gov.uk).

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.

SHEPD's request

Since 2015, SHEPD have 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

SHEPD explain in their request⁷ to the Authority, that deferring the Subsea Cable Costs uncertainty application window to May 2018 or later will give them the time needed to:

- test the CBA model on eight subsea cables during the marine licence application process with Marine Scotland,⁸ commencing in spring 2016 and requiring extended dialogue with all interested marine stakeholders;
- assess what level of reliance they can place on the CBA and its conclusions to inform their cost forecasts; and
- incorporate evidence of cost efficiency from actual cable replacement projects from the year following the Marine Scotland licence award (2017).

In their opinion, this will reduce the uncertainty in their application for additional funding to Ofgem.

Our decision

We have considered SHEPD's request and the 1 response we received to the consultation published 12 April 2016, referenced above. 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 and consultation respondents, we consider that it would be appropriate to agree to SHEPD's request and defer the uncertainty mechanism application window for Subsea Cable Costs under CRC 3F.11(a) to a **window that opens on 1 May 2018 and closes on 31 May 2018, 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 evidence of expenditure and cost efficiency from actual built out cable replacement projects into their uncertainty mechanism application.

⁶ <http://news.ssepd.co.uk/submarinecables/>

⁷ <https://www.ofgem.gov.uk/publications-and-updates/rrio-ed1-consultation-deferral-application-window-shepd-subsea-cables-costs-uncertainty-mechanism>

⁸ 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.

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

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 May 2018 and closes on 31 May 2018, or such later dates as directed by Ofgem.

Yours faithfully,

Kersti Berge
Partner for Networks and
Head of Ofgem in Scotland

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 DEFERAL 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 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 Cables 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 submitted a request to the Authority, seeking a deferral of the Subsea Cable Costs uncertainty mechanism application window from the current application window of 1 May to 31 May 2016 to 1 May to 31 May 2018, or later.
5. The Authority has considered SHEPD's request and has decided to agree and defer the uncertainty mechanism application window for Subsea Cable Costs under CRC 3F.11(a) to a window that opens on 1 May 2018 and closes on 31 May 2018, 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 evidence of expenditure and cost efficiency from actual built out cable replacement projects into their uncertainty mechanism application.

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 May 2018 and closes on 31 May 2018, 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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Kersti Berge
Partner for Networks and
Head of Ofgem in Scotland
Duly Authorised on Behalf of the Gas and Electricity Markets Authority
16 May 2016