

Title: Late delivery of wider works outputs  Project: MPR parallel works  Division: Networks Team: RIIO Electricity Transmission	<b>Impact Assessment (IA)</b>
	Date: 03/3/2017
	Stage: <b>Final</b>
	Source of intervention: <b>Domestic</b>
	Type of measure: <b>Price control</b>
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## Impact of proposals on Ofgem’s Strategic Outcomes

Strategic Outcomes	Overview of Impact
Lower bills than would otherwise have been the case.	The preferred option is likely to result in lower bills for customers.
Reduced environmental damage both now and in the future.	N/A
Improved reliability and safety.	The preferred option is likely to result in improved reliability and safety.
Better quality of service, appropriate for an essential service.	The preferred option is likely to result in better quality of service.
Better Social Outcomes	N/A

Quality Assurance Status	Reviewed
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## **Summary:** Intervention and Options

Rationale for intervention, objectives and options

### **What is the problem under consideration? Why is Ofgem intervention necessary?**

NGET and SPT will likely receive a financial benefit from the delay to Western HVDC. In setting the price control we did not specify any penalties for late delivery. Instead we said we would review deviations from the agreed completion timescales to determine whether these constitute a contravention of the licence conditions.

We consider that allowing the companies to benefit from delivering a project late and increasing costs to consumers represents a gap in the regulatory regime.

### **What are the policy objectives and intended effects?**

Our principal objective is to protect the interests of existing and future consumers.

We do not think that consumers are adequately protected. Consumers have funded the companies to deliver an output by a specific deadline, which will now not be met and NGET and SPT will likely receive a financial benefit from the delay.

### **What are the policy options that have been considered, including any alternatives to regulation? Please justify the preferred option (further details in Evidence Base)**

We have considered two options:

1. Do nothing; and
2. Delay allowances (preferred)

## Monetised Impacts (£m)

Business Impact Target Qualifying Provision	N/A
Business Impact Target (EANDCB)	N/A
<b>Net Benefit</b>	N/A

## Hard to Monetised Impacts

**Describe any hard to monetised impacts, including mid-tem strategic and long-term sustainability factors**

This policy would further incentivise Transmission Owners to deliver wider works projects on time as delaying allowances would remove a potential benefit from late delivery.

**Will the policy be reviewed?** Yes, as part of setting the next transmission price control.

**If applicable, set review date:** N/A

**Summary:** Analysis & Evidence

Policy Option 1

FULL ECONOMIC ASSESSMENT – Do nothing

Price base year: 2009/10	Base Year:	Time Period:	Net Benefit (£m)		
			Low:	High:	Best Estimate:
<b>COSTS (£m)</b>	<b>Total Transition</b> (Constant Price)	Years	<b>Average Annual</b> (excl. Transition)(Constant Price)	<b>Total Cost</b> (Present Value)	
<b>Best Estimate</b>					
<b>Description and scale of key monetised costs by 'main affected groups'</b>					
<p>This is the do nothing option or business as usual (BAU) scenario. Under this scenario we assume that there are no additional costs to the ones estimated in the current price control baseline. Therefore, costs are £0.</p>					
<b>Other key non-monetised costs by 'main affected groups'.</b>					
<p>Companies could be insufficiently incentivised to deliver projects on time which may in turn harm consumers.</p>					
<b>BENEFITS (£m)</b>	<b>Total Transition</b> (Constant Price)	Years	<b>Average Annual</b> (excl. Transition)(Constant Price)	<b>Total Benefit</b> (Present Value)	
<b>Best Estimate</b>					
<b>Description and scale of key monetised benefits by 'main affected groups'</b>					
<p>Other key non-monetised benefits by 'main affected groups'.</p> <p>The company receives a timing benefit by delaying payments to the suppliers.</p>					
<b>Key Assumptions/sensitivities/risks</b>				<b>Discount rate (%)</b>	
<b>BUSINESS ASSESSMENT (Option1)</b>					
Direct impact on businesses (EANCB)				Score £m: N/A	

**Summary:** Analysis & Evidence

Policy Option 2

FULL ECONOMIC ASSESSMENT – Delay allowances

<b>Price base year:</b> 2009/10	<b>Base Year:</b>	<b>Time Period:</b>	<b>Net Benefit (£m)</b>		
			<b>Low:</b>	<b>High:</b>	<b>Best Estimate:</b>
<b>COSTS (£m)</b>	<b>Total Transition</b> (Constant Price)	Years	<b>Average Annual</b> (excl. Transition)(Constant Price)	<b>Total Cost</b> (Present Value)	
<b>Best Estimate</b>					
<p><b>Description and scale of key monetised costs by 'main affected groups'</b></p> <p>Transfer of the timing benefit (from incurring costs later) from companies to consumers. Note that the amount transferred will depend on the approach taken and may not reflect the exact timing benefit achieved by the companies due to the delay.</p>					
<p><b>Other key non-monetised costs by 'main affected groups'.</b></p> <p>Adjusting the price control mid-period may have negative impacts on regulatory certainty and confidence.</p>					
<b>BENEFITS (£m)</b>	<b>Total Transition</b> (Constant Price)	Years	<b>Average Annual</b> (excl. Transition)(Constant Price)	<b>Total Benefit</b> (Present Value)	
<b>Best Estimate</b>					
<p><b>Description and scale of key monetised benefits by 'main affected groups'</b></p> <p>The monetised benefit is from the shift in Transmission Owner allowances which leads to a lower customer and network user bills. The scale of the benefits is unknown as no project has been delivered late yet.</p>					
<p><b>Other key non-monetised benefits by 'main affected groups'.</b></p> <p>Removing any potential benefit of late delivery for companies, this also will strengthen incentives for companies to deliver on time.</p>					
<b>Key Assumptions/sensitivities/risks</b>			<b>Discount rate (%)</b>		
<b>BUSINESS ASSESSMENT (Option1)</b>					
Direct impact on businesses (EANCB)				<b>Score £m:</b>	

## Evidence Base

### 1. Scope of this IA

This IA is to analyse the policy options to address late delivery of projects, applying it to the example of Western HVDC.

### 2. Problem and rationale for intervention;

The Western HVDC is a £1 billion subsea link, jointly developed by NGET and SPT. The link was intended to be delivered in 2016/17 but has been delayed to 2017/18.

The objective of the Western HVDC is to provide additional capacity to allow electricity to be transmitted between Hunterston in Scotland and Deeside in Wales.

Transmission networks do not have unlimited capacity. In some cases there is a 'constraint' which limits how much energy can be transmitted at certain times and locations.

Network constraints can arise due to the connection of new generators. Where economic, the transmission network is reinforced to provide additional capacity. Until the new assets are installed and where it is not economic to build new transmission assets, National Grid, as system operator, manages these constraints. This is generally achieved by paying generators to limit how much electricity is produced.

The Western HVDC is expected to significantly reduce constraint payments in the order of £140 million per year.<sup>1</sup> Due to the delay, these costs will continue until the Western HVDC is delivered, after which costs will fall. As the delay will be about six months, we expect the cost of the delay to be around £70 million. Actual costs will differ based on when the Western HVDC comes online and the generation and demand patterns that occur. It is possible that constraint costs could be higher or lower than our rough estimate.

Due to the delay, we expect NGET and SPT to pay suppliers later. Funding was provided assuming that the Western HVDC will be delivered on time. As a result, NGET and SPT are able to hold onto the funding before it is spent. This provides a timing benefit. If we take no action, NGET and SPT will retain a share with the rest being shared with consumers through the total expenditure sharing mechanism.

In setting the price control we did not specify any penalties for late delivery of the Western HVDC. Instead we said we would review deviations from the agreed completion timescales to determine whether these constitute a contravention of the licence conditions.<sup>2</sup>

### 3. Policy objective

The policy objective is to remove any automatic benefits companies receive for late delivery. The intended effect of this is to incentivise companies to deliver on time by removing the benefit of late delivery.

### 4. Which parties may be affected?

The main affected groups are:

- Companies that may deliver wider works projects late.
- Consumers or potential network users who could be adversely affected by the delay

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<sup>1</sup> National Grid 2015, *Connect & Manage Forecast Report*, April p.15

<sup>2</sup> Ofgem 2012, *Decision on funding arrangements for the Western High Voltage Direct Current link ("Western Bootstrap")*, p.10

## 5. Options and calculation of monetised impacts

We have considered two options. First doing nothing and second shifting back allowances to remove the potential benefits from delay.

### 1. Do Nothing

This option allows companies to receive timing benefits by paying contractors later than they receive the price control allowances. This creates perverse incentives as companies will be better off delaying projects even though consumers are worse off.

### 2. Delay allowances

This option shifts allowances to remove the timing benefit. This is to ensure that companies do not benefit from delayed projects that cause consumers to be worse off. Doing so further incentivises companies' timely delivery.

This will be implemented by making changes to the price control financial model. There are a number of ways to shift allowances which are discussed in the MPR parallel work consultation document.

#### Example

Western HVDC a £1bn subsea link is expected to be delivered late. For illustrative purposes consider a case where a project is delivered 1 year late and the companies are able to defer all payments by 1 year. We calculate the time value of money based on the weighted average cost of capital of 4.55%.

The benefits in the table below show the added returns rate that NGET would receive if there was a late delivery of one year and all payments are delayed by one year. This is from receiving an interest rate on each year's allowance. The red arrows intend to show one method of implementing our proposed solution to ensure the company doesn't receive this benefit from delivering late.

09/10 price base	13/14	14/15	15/16	16/17	17/18	18/19	19/20	20/21	Total
<b>NGET allowance</b>	162	230	209	20	-	-	-	-	621
<b>NGET pay contractors</b>	-	162	230	209	20	-	-	-	621
<b>Benefit to NGET</b>	-	7.4	10.5	9.5	0.9	-	-	-	28.3