

## SHEPD CUSC Modification Proposals - Impact of DNO Contributions on Actual Project Costs and Expansion Factors

### Appendix – TCMF queries

#### **SHEPD responses to queries raised at TCMF pm 9 January 2020, provided for Panel consideration in conjunction with SHEPD CUSC Modification Proposals 1 and 2**

##### **Overview**

The Authority decision on SHEPD's contribution proposals changes only the transmission link project costs allowed to be recovered by a TO, and only in the specific circumstances where the Authority has approved a contribution.

SHEPD's CUSC mod proposal is a change only to define that this revised, Authority-determined transmission cost value is used as the basis for transmission charges, as the Authority determines TO allowed revenue at every price control. SHEPD's proposals do not change any mechanism which drives locational charging.

A change to the value of "actual project costs", further to a determination by the Authority to agree a contribution by a DNO to offset these costs, is no different in effect to the Authority determining a specific cost value for a TO for the purpose of cost recovery. E.g. a DNO may propose a £10m contribution to reduce link costs, or the Authority may determine a £10m reduction of the amount a TO is permitted to recover – the effect is the same.

##### **Query 1: A contribution will reduce the value of the transmission network, and will therefore water down TNUoS locational charging signals. (Paul Jones, Uniper)**

The values that go into TNUoS methodology are used to set relative price signals. TNUoS methodology sets locational signals in tariff-setting. The contribution reduces the value of the transmission network, and therefore waters down the locational signals.

It is not clear whether this is accepted as a consequence and, if not, how it would be managed. If the locational signals are not permitted to be diluted, then the methodology may need to be changed such that tariff-setting continues to use the gross rather than netted off MAR amount, to maintain the signal (while methodology for recovery of TO MAR uses the netted off MAR amount).

The Panel may want a workgroup to be able to consider / document this effect.

##### **SHEPD response:**

The Authority has made a determination that a DNO may contribute towards the cost of a transmission link, such that the total cost is shared, and transmission costs and TNUoS charges are reduced. Under this arrangement "SHEPD customers would...pay for [a] proportion of the transmission link" with the net allowable transmission cost being finalised at the end of construction.

The contribution value and DNO cost recovery arrangements are determined by the Authority, as is the TO allowed revenue. The Authority decisions on the contribution value which may be made and recovered by SHEPD, and the net link cost which may be recovered by SHET, are effectively price control decisions. In a CUSC context there is no further change – the only change is to clarify that the actual project cost value at 14.15.75 may be net of a contribution

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and, again, that if this is the case, actual project costs which are net of a contribution should be pro-rated across local and wider TNUoS charges exactly as they are under the current methodology – this clarification is made purely for the avoidance of doubt on this point. There is no further change to TNUoS methodology.

Aside from the proposed modification to make clear that “actual project costs” may be a value from which an adjustment has been netted off, there is no change to TNUoS methodology. The arrangements will have an impact on TNUoS charges, but not because of any methodology change, other than netting off contribution – this change will be driven simply by a change in the starting net cost, just as a change in TO AR will change charges.

The contribution is applied to the total project cost, and is pro-rated across costs attributed to local and wider TNUoS charges in order that it applies to each according to the existing pro-rating in place under TNUoS methodology. As such, there is no locational charge distortion (the modification at 14.15.76 seeks to prevent any such distortion) – the costs are attributed to local and wider charges exactly as they are at present, and determine tariffs mechanistically as a result of the application of the existing methodology.

In summary as far as SHEPD understands, there are no special impacts specific to the CUSC modification which SHEPD has proposed. The nature of the impact is the same as would arise with any change to allowed revenue which the Authority directs, given that the sum effect of SHEPD’s proposed modification is to effectively change the allowed revenue value; and all aspects other than this modification are out with the scope of the CUSC modification process. Just as we would not expect a workgroup to consider the “unintended consequences” of an Authority decision setting the allowed recoverable cost of a transmission link as a result of a project assessment, we would not expect a workgroup to consider the “unintended consequences” of an Authority decision setting the allowed recoverable cost of a transmission link which the Authority has determined is net of a third party contribution. Both examples interact with the CUSC in exactly the same ways.

**Query 2: Information should be provided on wider implementation, e.g. licence changes, to demonstrate that there are measures in place to prevent “missing money” or over-recovery of money. (NGESO)**

#### **SHEPD response:**

It is the Authority’s remit to determine the allowed revenue for the DNO and the TO, the appropriate allocations for the recovery of these costs, and the prevention of under- or over-recovery by the DNO and / or the TO. The Authority has confirmed that it expects “modifications to both SHEPD’s distribution licence and SHET’s licence to... be required”, with all associated statutory consultation. Specifically, the Authority has set out that:

“The implementation of these arrangements would also require a formalised process for the contribution to be transferred from SHEPD to SHE-T through the TO and DNO licences. We would work with the relevant parties to develop the required licence amendments, and we would aim to implement the changes, following a formal

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consultation process in time to allow the contribution to be made at the end of construction.

“If we approve a Final Needs Case for either project, we would then undertake a ‘Project Assessment’ process to determine the efficient capital costs for the project. Subject to implementation of changes to industry codes and licences referred to above, we would at the conclusion of the Project Assessment set the final contribution figure for Shetland. This contribution would be paid by SHEPD to SHE-T at the end of construction, and revenue allowances would be adjusted accordingly in SHE-T and SHEPD’s licences.” - [Authority Decision](#), 17 December 2019, p.2, 8

The Authority, SHEPD and SHET have engaged numerous times on the DNO and TO cost recovery proposals, and proposals are being progressed with regards to the appropriate licence mechanisms and drafting to appropriately implement the proposals. The Authority is keenly aware of its responsibility to prevent under- and over-recovery and this has been the specific subject of several conversations. The adjustments which the Authority’s decision describes above will ensure that on a net basis neither the DNO nor the TO under- or over-recover – indeed they set out in their decision that

“This licence change process, which will be subject to formal consultation, will ensure that the contribution can be processed in a clear and transparent manner that **ensures that consumers are no worse off as a result of the way the change is implemented.**” - [Authority Decision](#), 17 December 2019, p.12

In the Authority will ensure the correct amounts are recovered by SHEPD and SHET, and associated details will be open to public consultation in due course.

#### **Query 3: If the contribution is added to AAHEDC it will increase TNUoS charges. (Paul Jones, Uniper)**

##### **SHEPD response:**

The mechanisms and “pots” for cost recovery are established, and SHEPD proposals do not change any of these mechanisms. For example, the function, mechanism and justification for the Hydro Benefit Replacement Scheme (HBRS) / Assistance for Areas with High Distribution Costs (AAHEDC) mechanism is not within SHEPD’s remit or within the scope of the contribution proposals. Charges associated with the AAHEDC may change, as they do with all changes to allowed revenue. The AAHEDC is a mechanism deemed to be of societal benefit determined by BEIS, and subject to 3-yearly consultation processes.

BEIS has [consulted](#) upon the inclusion of the higher costs of meeting security of supply on Shetland within the AAHEDC mechanism, adding those costs to the existing assistance amount, and in that consultation was minded to approve this proposal. If the Shetland transmission solution is approved, the SHEPD cost recovery amount associated with the contribution is expected to be added to the AAHEDC amount. BEIS’ decision on this is expected imminently.

The decisions on the specific cost recovery arrangements for SHEPD and SHET are for the Authority to determine, and will be subject to public consultation.

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In summary as far as SHEPD understands, the amount or mechanics of cost recovery via the AAHEDC is not relevant for the purpose of the proposed modification that we have put forward.

#### **Query 4: Further consideration is required to determine the interactions between the proposed SHEPD CUSC modification and CMP 303.**

##### **SHEPD response:**

SHEPD's Legal Text changes have been made on the basis of CMP 301, which is the last approved changes to the relevant sections.

As far as SHEPD understands CMP 303, it deals primarily with the pro-rating of project costs between the local and wider TNUoS charge elements. SHEPD's proposals deal only with the starting project cost value, confirming a value net of a contribution in some cases in place of the gross value, and do not impact upon pro-rating at all. Therefore our Legal Text additions would remain – the principle of a project cost net of a contribution would remain unaffected, and CMP 303 would effect any changes to pro-rating that were approved. CMP 303 would drive a change in the allocation of cost between local and wider TNUoS charges, but would not change the starting project cost value to which the pro-rating is applied.

Where a contribution has been approved by the Authority, we would expect it to be maintained through any further revisions to cost allocation taken forward under CMP 303.