

True Up, Logging Up and Re-openers: SSEN Transmission RIIO-T2 Proposals



Inverlmond House, 200 Dunkeld Road, Perth PH1 3AQ  sSEN.co.uk

Scottish and Southern Electricity Networks is a trading name of: Scottish and Southern Energy Power Distribution Limited Registered in Scotland No.SC213459; Scottish Hydro Electric Transmission plc Registered in Scotland No. SC213461; Scottish Hydro Electric Power Distribution plc Registered in Scotland No. SC213460; (all having their Registered Offices at Inverlmond House 200 Dunkeld Road Perth PH1 3AQ); and Southern Electric Power Distribution plc Registered in England & Wales No.04094290 having their Registered Office at No. 1 Forbury Place 43 Forbury Road Reading RG1 3JH which are members of the SSE Group www.sSEN.co.uk

T2BP-DD-SHE-010	True Up, Logging Up and Re-openers: SSEN Transmission RIIO-2 Response	
		Issue Date: September 2020

Contents

1	Introduction	1
2	Principles and definitions.....	1
3	Where true up shouldn't apply in RIIO-T2.....	2
4	SHE-T Proposals: Areas Subject to True up or Logging up in RIIO-T2.....	5
5	Reopeners	8

T2BP-DD-SHE-010	True Up, Logging Up and Re-openers: SSEN Transmission RIIO-2 Response
	Issue Date: September 2020

1 Introduction

This paper summarises SHE Transmission’s proposals for the true up mechanisms for RIIO-T2 that are contained in three of Ofgem the Draft Determinations documents – *Core Document, Electricity Transmission Annex* and *Scottish Hydro Electric Transmission Annex*.

2 Principles and definitions

True up or logging up should be used in exceptional and clearly pre-defined circumstances in ex ante output- and incentive-based regulation. To use this important regulatory mechanism excessively or where it has been loosely defined risks turning ex ante regulation into ex post regulation, thus losing the consumer benefits associated with an ex ante regime, i.e. incentivising licensees to strive for outperformance through innovation and efficiency. It also increases regulatory risk whereby licensees are exposed to the uncertainty of an ex post determination, meaning all expenditure has the potential for disallowance – again this discourages innovation and responsiveness to changing circumstances.

Our clear and simple definition of ‘true up’ and ‘logging up’ is set out below. The distinction between them is important.

Both mechanisms modify allowances to match actual spend (mainly at the “Close Out” of the relevant Price Control period but sometimes during the Price Control) and therefore the Totex Incentive Mechanism (TIM) doesn’t apply. For that reason, there must be sound rationale for their use as this is a departure from the RIIO framework (i.e. a departure from the use of a core incentive). For example, where the costs are almost entirely outside the control of the licensee (e.g. business rates and landowner compensation) or where costs are uncertain when ex ante allowances are made but it’s important to make those allowances to meet core policy objectives (e.g. pre-construction baseline allowances).

An **ex-post efficiency review** is a key factor that distinguishes ‘true up’ from ‘logging up’, i.e. it is undertaken for true up but not for logging up. It is only appropriate where the licensee has some **control** over the costs incurred and therefore it would not apply in a logging up scenario. It is important that any ex-post efficiency review does so without the benefit of hindsight and is conducted in a manner that is timely, proportionate and transparent.

Another key distinction between ‘true up’ and ‘logging up’ is the **value of allowances** in question. For areas of the price control that have a value of allowances which are less material compared to other areas subject to true up and/or a Close Out assessment, logging up may be more suitable. Logging up may also be more suitable for costs that will be recovered directly from customers. This is critical in achieving **proportionate regulation**.

T2BP-DD-SHE-010	True Up, Logging Up and Re-openers: SSEN Transmission RIIO-2 Response
	Issue Date: September 2020

Directly related to proportionate regulation is the use of a **materiality threshold** to determine if true up should be triggered. If the value in question (i.e. over or underspend) exceeds the value of the regulatory burden of undertaking the ex post efficiency review then it reasonably follows that it should be triggered. If not, it shouldn't be triggered. We do not believe that a proportion of base revenue is an appropriate trigger threshold. Instead the trigger should be a fixed absolute value and we suggest that this fixed absolute value should be set at c£1m-£2m for the RIIO-T2 price control.

Table 1: Definition of True up versus Logging up

	True up	Logging up
Allowance modification	Symmetrical (up or down) modification of allowances to match actual spend	Symmetrical (up or down) modification of allowances to match actual spend
Does TIM apply?	No	No
Efficiency review required?	Yes. Based on an ex-post efficiency review of actual costs	No. Adjusted based on a record of what licensees actually spend
Application or automatic?	Application. Licensee to make submission for true up as part of RIIO-T2 Close Out in 2026/27	Automatic. Adjustment through legacy workbooks at end of the price control (or at agreed in-period) period based on regulatory reporting.
Materiality threshold required?	Possibly. Can work with or without a materiality threshold (up or down), depending on the cost category in question. If with, the dead band should be based on proportionality of work involved in undertaking the true up i.e. so that regulatory costs don't exceed the value of the true up. A reasonable assumption would be £1-£2m.	No. There is no regulatory impact (as automatic) and for some it is immaterial.

3 Where true up should not apply in RIIO-T2

Before detailing what we believe should be subject to true up, and logging up, and defining exactly how the mechanism should be applied in each individual case, we first set two areas where we don't agree with Ofgem that true up should apply - T2/T3 cross over scheme (East Coast 400kV Incremental Upgrade) and Medium Size Investment Projects (MSIP).

In both cases, the criteria for applying true up are absent. For both, the need is certain at the time of making allowances, the costs are (largely) within the control of the licensee and allowances are made in advance of expenditure.

To introduce a **cost** true up and remove the TIM to these areas only exacerbates the dampened incentive regime we see in RIIO-T2. The consequences of it including reduced incentives to innovate and reduced incentives to seek cost efficiencies that will form the basis of many costs for RIIO-T3 and beyond. This, we believe, is not in the long term interests of consumers and goes against the established strength of GB utility regulation.

T2BP-DD-SHE-010	True Up, Logging Up and Re-openers: SSEN Transmission RIIO-2 Response
	Issue Date: September 2020

Ofgem give no rationale for its proposals to true up the costs in these areas. It does not state why the East Coast 400kV Incremental Upgrade scheme should be treated differently to, for example, cross over volume driver schemes where the TIM applies. Nor does it set out why adjustments to the baseline allowances for MSIP projects should be treated differently to any other revisions to baselines.

Ofgem has provided no consideration for either the proportionality of the proposed regulatory intervention or the associated risk to licensees. It has failed to consider the risk on the TOs of a true up *with an efficiency review* that it is considering not only for MSIP but component parts of the price control. We will provide a comprehensive view on risk in response to Ofgem's impact assessment published on 31 July by 25 September 2020.

T2/T3 Cross Over Schemes (East Coast 400kV Incremental Upgrade)

This is an example where the RIIO-T2 output is delivered in RIIO-T3. But, of a £257m project, £222m (86%) of expenditure is profiled in RIIO-T2. This is by all intents and purposes a RIIO-T2 project with the outputs delivered in early RIIO-T3. This should, therefore be subject to the RIIO-T2 framework including the T2 TIM Sharing Factor. We propose that Ofgem treat this as such and allow us the opportunity to find cost efficiencies in almost a quarter of the total value of our load related RIIO-T2 expenditure (£871m).

The proportion of expenditure that is forecast to be incurred in RIIO-T3 should be agreed as part of the RIIO-T2 settlement and included in the RIIO-T3 base allowance.

We plainly commit to the output (ultimately in RIIO-T3) and this is dealt with through the Price Control Delivery (PCD) framework (see response to SHET Q3), but not to a true up of costs with an ex post efficiency assessment.

Medium Size Investment Projects (MSIP)

We do not support a true up of the MSIP as it applies to both Generation and Demand Connections and the various reopener elements.

As noted, an efficiency true up by design, leaves no opportunity for outperformance and by confirming deliverable cost and outputs ex ante then licensees can be appropriately incentivised. It is not clear why Ofgem thinks that is not the case for MSIP.

Regarding generation and demand connections, in almost all cases (if not all) at the time the uncertainty mechanism/atypical scheme is reviewed and a decision is made, any cost uncertainty will be no more than that which exists when a price control is settled. That's the rationale for delaying the decision. Therefore, the TIM should apply and the allowed costs should not be subject to a true up.

Regarding the other re-opener elements, there will be some unusual events where need has become certain but costs can vary. We should treat these as the exception. Of the items listed under part 2 of MSIP, we believe they should all be capable of being cost certain at the time of the reopener decision.

T2BP-DD-SHE-010	True Up, Logging Up and Re-openers: SSEN Transmission RIIO-2 Response	
		Issue Date: September 2020

Volume Driver Allowances

We do not support a true up of volume driver allowances related to generation and demand connections. The allowances for volume driver schemes should be adjusted annually to reflect the latest generation forecast and allowances in line with either the RIIO-T1 (for schemes connection in the first two years of RIIO-T2) or RIIO-T2 Volume driver recovery mechanisms.

4 SHE-T Proposals: Areas Subject to True up or Logging up in RIIO-T2

Table 2: True Up and Logging Up in RIIO-T2

Area	Description	True Up or Logging up	Date	TIM Apply	Materiality	Comments/Justification
Pre-construction Large Strategic Schemes (identified in baseline allowance)	Revised baseline justification proposed for 5 x schemes for inclusion in our baseline allowances – total forecast £124.5m	Symmetrical true up of costs.	Close out only (2026/27)	No	Yes (TBC)	<ol style="list-style-type: none"> 1. Ring fence the five projects from in-period additional schemes. 2. All are subject to PCD framework. Ensure PCDs delivered. 3. Next, if PCD delivered true up applies as normal. 4. Subject to materiality and ex post efficiency assessment, underspent allowances returned, overspent allowances permitted <p>Note: reopener proposed for baseline schemes if scope/drivers change (e.g. public inquiry) so assessment based on any revised allowances.</p> <p>Protects customers from overspend and ensures vital expenditure to meet Net Zero.</p>
Pre-construction Large Strategic Schemes (identified in period-reopener)	In period reopener proposed for schemed for new future schemes additional to the 5 schemes above (they are baseline allowances) or material modifications.	Symmetrical true up of costs.	Close out only (2026/27)	No	Yes (TBC)	<ol style="list-style-type: none"> 1. Ring fence any new projects from baseline schemes. 2. All are subject to PCD framework. Ensure PCDs delivered. 3. Next, if PCD delivered true up applies as normal. 4. Subject to materiality and ex post efficiency assessment, underspent allowances returned, overspent allowances permitted. <p>Protects customers from overspend and ensures vital expenditure to meet Net Zero.</p>

T2BP-DD-SHE-010	True Up, Logging Up and Re-openers: SSEN Transmission RIIO-2 Response
	Issue Date: September 2020

Annual NOA scheme Development & Regional Plan Development	£4.5m baseline allowances	Symmetrical logging up.	Close out only (2026/27)	No	No	Logging up as per table 1 Protects customers from overspend and ensures vital expenditure to meet Net Zero. Materiality supports logging up versus true up at close out.
Advanced PCF for T3 schemes: T3 LRE schemes T3 NLRE schemes	£24m (based on a symmetric true up at end of period)	Symmetrical logging up.	Close out only (2026/27)	No	No	Logging up as per table 1 Protects customers from overspend and ensures vital expenditure to meet Net Zero. Materiality supports logging up versus true up at close out
Landowner Compensation	£32m baseline ask and log up	Symmetrical logging up.	Close Out only (2026/27)	No	No	Logging up as per table 1. Protects customers from baseline being set incorrectly by automatically returning unspent allowances, Scale of potential costs too large not to set baseline and SHE Transmission to wait until 2026/27. Landowner compensation close to pass through. Similar to business rates, as long as SHE Transmission demonstrate all reasonable steps have been taken this should be automatic adjustments as no justification for ex-post efficiency assessment.
Brexit	No baselines set. Propose recovery of costs if impacts.	Asymmetrical (upside) logging up. 2023/24 (for first two years) Close out (for years 3-5).	2023/24 (for first two years) Close out (2026/27) (for years 3-5)	No	No	Only implemented where tariffs are changed. Tariffs entirely outside our control and therefore logging up with no materiality over true up as no justification for ex-post efficiency assessment.

T2BP-DD-SHE-010	True Up, Logging Up and Re-openers: SSEN Transmission RIIO-2 Response	
		Issue Date: September 2020

Dynamic Line Rating	£13m baseline ask for installation recent innovation of DLR on 7 overhead lines	Asymmetrical (downside) true up	Close Out only (2026/27)	No	Yes (TBC)	<ol style="list-style-type: none"> 1. All are subject to PCD framework. Ensure PCDs delivered. 2. Next, if PCD delivered true up applies as normal as total. 3. Subject to materiality and ex post efficiency assessment, underspent allowances returned, overspent allowances permitted
Transmission Connection Assets (Entry & Exit)	£16.6m included in baseline business plan proposal relating to 7 schemes	Symmetrical logging up	Annually	No	No	<ol style="list-style-type: none"> 1. Logging up will occur annually, with a two year look ahead forecast included based on the latest generation forecast 2. The TCA forecast will be aligned with the generation forecast and associated infrastructure elements that will be assessed under the volume driver recovery mechanism

5 Reopeners

Reopeners are a distinct regulatory tool from true up or logging up. For reopeners, allowances are being made either for the first time (either for a new or materially modified output). This is different from true up or logging up which adjust previously made allowances. Note that a reopener may (or may not) be trued up or logged up.

Our full list of RIIO-2 reopeners is provided in Table 3 below. We set out our understanding of the key principles of the design of these re-openers – reopener windows, materiality thresholds and if true up or logging up applies.

This provides Ofgem with one central source of our position on the reopeners which span a number of questions across the response.

It also allows the consideration of true up / logging up as it does apply to what Ofgem describes as a close out reopener window, but is actually a true up / logging up. This applies to the following reopeners:

- Physical site security;
- MSIP (reopener element only, not the demand and generation connections);
- Pre-construction (new strategic schemes);
- Pre-construction (significant change in scope for 5 large strategic schemes in baseline);
- Legislative, Policy & Standards; and
- Subsea cables

An important distinction is to be made. Where the reopener window is in-period and the costs are forecast, these costs should be treated like any other baseline costs and should be subject to the TIM (for the reasons outlined above in Section 3) without any true up or logging up. However, between the re-opener window (be that January 2023 or January 2024) there may be additional unforeseen costs incurred that the TO is entitled to recover. As these are driven by a third party and if not reasonably foreseen, it is appropriate that the expenditure is recoverable. In this situation, the close out reopener window is actually a true up / logging up and the TIM will not apply.

Table 3: Re-openers in RIIO-T2

Re-opener Name	Re-opener windows	Materiality Threshold	True-up issue
Cross Sector Re-openers			
Cyber Resilience OT (Core Q6)	Ofgem: April 2021 and January 2023 SHET: Agree	Ofgem: None SHET: Agree	
Cyber Resilience IT (Core Q6)	Ofgem: April 2021 and January 2023 SHET: Agree	Ofgem: None SHET: Agree	
Information Technology and Telecoms (IT&T) (Core Q18)	Ofgem: April 2021 and January 2023 SHET: Agree	Ofgem: None SHET: Agree	

T2BP-DD-SHE-010	True Up, Logging Up and Re-openers: SSEN Transmission RIIO-2 Response	
		Issue Date: September 2020

Physical Security (Core Q22) (Core Q19)	Ofgem: 2023 and Close Out (2026) SHET: Agree	Ofgem: 1% of annual base revenue SHET: None	Ofgem: refers to close out window (but unclear on intent and if/how true up applies) SHET: close out true up only for elements unforeseen at Jan 2023 window
Net Zero (Core Q23)	Ofgem: Ongoing SHET: Agree	Ofgem: 1% SHET: None or regulatory burden value (c£1m-£2m)	
Whole systems 'Coordinated Adjustment Mechanism' (Core Q13-15)	Ofgem: TBD SHET: TBD	Ofgem: None SHET: Agree	
Pension scheme established deficit	Ofgem: Triennial review SHET: Agree	N/A	
Tax liability allowance	Ofgem: Ongoing SHET: no requirement for window as pass-through	Ofgem: 0.33% SHET: None	
ET Sector Re-openers			
LOTI (ET Q10)	Ofgem: Ongoing SHET: Agree	Ofgem: £100m+ SHET: Agree	
MSIP – third party driven reopener elements* (ET Q13)	Ofgem: January 2024 and true up at Close Out SHET: January 2024 and Close Out for areas unforeseen in Jan 2024 window	Ofgem: 1% annual base revenue (but not clear if 1% applies to each component or combined) SHET: None or collective regulatory burden value of c£1m-£2m	Ofgem: true up of costs SHET: close out true up only for elements unforeseen at Jan 2024 window
MSIP – generation and demand connections (ET Q13)	Ofgem: January 2024 and true up at Close Out SHET: as/when required and no true up	Ofgem: £25m-£100m SHET: <£100m	Ofgem: true up of costs SHET: no true up
Pre-Construction Funding: new large strategic schemes (ET Q12)	Ofgem: *NO REOPENER* Close Out only	Ofgem: N/A SHET: None	Ofgem: N/A SHET: Symmetrical true up of costs subject to a

T2BP-DD-SHE-010	True Up, Logging Up and Re-openers: SSEN Transmission RIIO-2 Response	
		Issue Date: September 2020

	SHET: annual c1 March (1 month after publication of NOA)		materiality threshold (see above).
Pre-Construction Funding: significant change in scope for 5 large strategic schemes in baseline (ET Q12)	Ofgem: *NO REOPENER* Close Out only SHET: ongoing/as required	Ofgem: N/A SHET: None	Ofgem: N/A SHET: Symmetrical true up of costs subject to a materiality threshold.
Visual Impact Provision (VIP) (ET Q7)	Ofgem: Ongoing SHET: Agree	Ofgem: None SHET: Agree	
Legislative, Policy & Standards** (Core Q20)	Ofgem: seeking views (currently no re-opener) SHET: January 2024 and Close Out	Ofgem: seeking views (currently no re-opener) SHET: None or collective regulatory burden value of c£1m-£2m	Ofgem: seeking views (currently no re-opener) SHET: close out true up only for elements unforeseen at Jan 2024 window
SHE Transmission Re-openers			
Exceptional Subsea Cable Fault Costs (SHET Q12)	Ofgem: January 2024 and Close Out SHET: Agree	Ofgem: 1% of annual base revenue SHET: None or regulatory burden value of c£1m-£2m	Ofgem: refers to close out window (but unclear on intent and if/how true up applies) SHET: close out true up only for elements unforeseen at Jan 2023 window

*MSIP third party driven reopener comprises the following areas in our view:

- Flooding, Wildfires & Extreme Weather (extended from Ofgem proposal – see ET Q13 and core Q20)
- Black Start (as per Ofgem proposal)
- ESO-driven requirements (as per Ofgem proposal)
- Projects to maintain SQSS compliance (as per Ofgem proposal)
- Harmonic Filtering (as per Ofgem proposal)
- Energy Data Taskforce recommendations (as per Ofgem proposal)
- Operational Load Management Schemes (as per Ofgem proposal but to include not only SPT but also SHE Transmission – see ET Q13)
- Shunt reactors (no longer volume driver – see ET Q13)

T2BP-DD-SHE-010	True Up, Logging Up and Re-openers: SSEN Transmission RIIO-2 Response	
		Issue Date: September 2020

** Legislative, Policy & Standards comprises the following areas in our view (see core Q20):

- Energy Code Review, Significant Code Review, Transmission Owner Code (STC) Operational Load Management Schemes;
- Access Reform & Significant Code Review;
- Environment and Climate Change;
- HSE's Electricity Safety, Quality and Continuity Regulations (ESQCR)