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Ofgem
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By e-mail: RIIOElectricitytransmission@ofgem.gov.uk

Dear James

Consultation on the Eastern Green Link 2 Project Assessment

We welcome the opportunity to respond to Ofgem's consultation on its review of the Eastern Green Link 2 (EGL2) project assessment (PA).

We would like to note our appreciation for the openness and responsiveness from Ofgem during the lengthy engagement on the EGL2 project assessment. We appreciated the willingness of the Ofgem team to work with the EGL2 Incorporated Joint Venture (IJV) to identify the optimal approach to facilitate timely decision-making (in the interests of consumers). This was important as the IJV sought to negotiate with the supply chain in a highly dynamic and challenging market environment. We would expect Ofgem to exhibit similar flexibility on the assessment of future large scale transmission investments (including as part of the work on the respective TOs' ASTI portfolios). SSENT and NGET will reciprocate accordingly by engaging with the regulatory process in a collegiate and transparent manner. Flexibility will be crucial in enabling the UK and Scottish Governments to meet their legislated net zero targets.

We have set out our responses to Ofgem's consultation questions below. There are a number of confidential (and/or commercially sensitive) details which should be redacted before publication of this response on Ofgem's website. We have marked these in square brackets and **blue text**.

Q1. Do you agree with our minded-to position on direct costs on EGL2?

We agree with Ofgem's minded-to position on direct costs on EGL2 but have the following comments to make:

- In relation to the IJV's proposals for Community Benefit Funding, Ofgem note (in 3.12) that "the sum requested by the JV is in line with recent historic norms and based upon sound principles." We have inferred from this paragraph and the total direct cost allowances awarded **[REDACTED]** that Ofgem are minded-to approve the funding requested for the CBF in full. However, this is not explicitly stated in the consultation. We would appreciate if Ofgem could confirm this in writing. Both TOs continue to engage with DESNZ ahead of the anticipated publication of their framework

for funding initiatives in communities affected by large-scale infrastructure investments. We will look to reflect the parameters of that framework in any funding requests planned for future uncertainty mechanism submissions.

- [REDACTED]

Q2. Do you agree with our minded-to position on indirect costs and P50 level of confidence funding on EGL2?

We agree with Ofgem's minded-to position on indirect costs and P50 funding on EGL2 but have the following comments to make:

- In our PA submission, we proposed that the Risk allowance be awarded on a 50:50 basis between the IJV partners. This proposal was made on the basis that it is not possible to accurately forecast the actual split in allowances which may be required once we enter into execution. There is a recognition within the project that the eventual outturn position following construction may not reflect a neat 50:50 split. For example, it is not inconceivable that there could be increased risk materialisation at one end of the link than the other. [REDACTED]. In order to ensure that neither TO is disproportionately exposed, we proposed within our PA submission that a mechanism be put in place within each TO's licence (applicable to EGL2 and other future joint venture projects) to ensure there is a legal / regulatory provision in place to true up regulatory allowances between the TOs where baseline allowances agreed do not reflect final outturn expenditure. We have included a proposal on the appropriate approach for this mechanism within the PA document. We would appreciate clarification from Ofgem that they accept the need for this to be introduced.
- We recognise that it is Ofgem's current position to only award risk contingency funding on LOTI projects based on a P50 confidence interval. However, as discussed with Ofgem during the PA engagement process, it remains our firm view that risk allowances should be based on an appropriate confidence level calibrated against the risk profile and overall complexity of the given project.

We accept that reliance on the P50 figure may be appropriate for certain projects. Across different infrastructure sectors in the UK (rail, energy, highways, water) - P-values typically used on projects range between P50 and P80. P50 is normally used for standard schemes delivered at a portfolio level where (accounting for a range of projects) this value may be the most appropriate for calibrating risk allowance. This makes sense as projects will typically come in as a mix of over- and under-budget delivery. In these circumstances, you can reasonably argue in aggregate there is 50% likelihood that individual projects will be delivered within budget.

However, P80 is justified in some instances for specific major projects where it is likely there are significant unknown (and therefore unquantified) risks or where there is a lack of opportunities to correct for optimism bias. Such projects may be, for example:

- more complex;
- not characteristic of more typical schemes delivered in portfolios;
- delivered over longer durations;
- subject to high public interest and scrutiny;
- programme critical;

- deploying innovative first-of-its-kind technologies;
- being constructed under novel operating models (e.g. joint venture); and/or,
- relying on as-yet-unbuilt manufacturing and construction capacity.

While we accept Ofgem's minded-to position on P50 funding for EGL2, we maintain that greater than P50 (e.g. P80) allowance could be more appropriate for projects of this level of complexity and strategic importance in future. As discussed with Ofgem, it is our view that meeting the UK's legislated net zero requirements will require substantial investment in people and infrastructure from all GB TOs (and UK PLC) over the next 25+ years. This will only be achieved with suitable financial stability and predictability – the essential cornerstones for long-term planning and investment.

We note again that public perception is highly pertinent for key enabling projects which underpin the UK and Scottish governments' legislated targets. It is important that projects are funded to ensure they can be delivered on time and to quality. Considering the public support which will be required for the next 25+ years, public perception of project 'overspend' - when in actuality the spend is conceivably in alignment with the modelled forecast risk outturn for such highly complex projects - could undermine public confidence in the governments' overall strategies. SSENT and NGET are established and sophisticated organisations, with mature risk management processes in place. We submit that the TOs can be better placed to execute projects of similar complexity and scale if allowed to operate with the appropriate level of elevated risk allowance (in line with the standard practice in other industries.)

Q3. Do you agree with our minded-to position on P80 contingency funding on EGL2?

As noted above, we maintain that a >P80 allowance may be more appropriate for projects of significant complexity and strategic importance. However, notwithstanding this view, we accept Ofgem's minded-to position on P80 contingency funding on EGL2.

[Our only concern relates to the lack of sufficient clarity within the consultation on how Ofgem envisage the interaction between the P50 allowance and the P80 ringfenced provision will work in practice. As Ofgem are aware, the EGL2 project is now preparing for execution following determination on the PA and execution of main contracts. As part of this process, we are scoping and establishing the required monitoring, management and reporting systems and processes. The IJV team continues to wrestle with the lack of clarity regarding Ofgem's expectations on risk, given some of the nuance in the determination position. In the interests of ensuring there is a common understanding between the IJV and Ofgem (to support work on the required systems and processes), we have set out below our understanding of the Risk position (all figures in 18/19 prices). This is our understanding of how risk is expected to work from a practical and conceptual perspective in the regulatory settlement for EGL2. This commentary of course omits any mention of inflation/indexation risk exposure which is managed using separate mechanisms:

- [REDACTED]

Q4. Do you agree with our minded-to position on PAMs funding on EGL2?

We agree with Ofgem's minded-to position on PAMs funding on EGL2. However, we have the following general comment to make:

- We explained in our PA submission that there may be uncertainty on EGL2 costs which are not associated with contractual supply chain indexation adjustments (i.e. PAMs). We noted that the EGL2 IJV partners require inflationary protection from such uncertainty and suggested that this would be provided through the application of CPIh to these costs. We would appreciate written confirmation from Ofgem that any costs not associated with contractual supply chain indexation adjustments (and associated allowances) will still receive inflationary protection via the application of CPIh.

Q5. Do you agree with our minded-to position on currency hedging funding on EGL2?

We agree with Ofgem's minded-to position on currency hedging funding on EGL2.

We would highlight the following text from the PA submission:

[REDACTED]

Ofgem has already confirmed that they will permit the required option fee. However, we would appreciate a discussion with Ofgem on item in bold as we do not believe it has formally stated its position on this.

Q6. Do you agree with our minded-to position on the deferred risks on EGL2?

We agree with Ofgem's minded-to position on the deferred risks on EGL2. We appreciate Ofgem's flexibility in recognising that the IJV would likely require further protection (via an adjustment to allowances) for four highly uncertain risks which were excluded from our PA submission. These related to: UXO target investigation; UXO clearance and detonation; the CPO process for the Southern land cable; and, uncertainty associated with the estimates on wider works.

We had previously proposed to update Ofgem on these by way of a further submission in Q2 2024. We no longer intend to submit this but instead will make a COAE application to adjust allowances as may be required but will ensure that we do so at a time which minimises the need for multiple submissions.

We continue to work on refining our understanding of the potential exposure on three of those risks. In relation to the wider works, there was a risk that the cost for the wider works would be substantially higher than could be reasonably foreseen (i.e. due to market conditions beyond the project's control.) We removed this risk from the 2B modelling as we expected to receive updated tender information in 2024. We intended to reflect this within the proposed reopener submission in Q2 2024. We included a direct cost request within the PA for these works of [REDACTED]. Ofgem has confirmed that they are minded-to allow these costs. The emerging contractor returns continue to indicate costs that are significantly higher than we had reasonably foreseen. [REDACTED]. The proposed COAE application (mentioned in the paragraph directly above) will include a request to adjust allowances to reflect this cost escalation.

Q7. Do you agree with our minded-to position on the COAE threshold adjustment on EGL2?

We agree with Ofgem's minded-to position on the COAE threshold adjustment on EGL2. We have the following general comment to make on this topic:

- The LOTI framework provides protection from high impact, low probability events via the cost and output adjusting events (COAE) mechanism. This is subject to a threshold of 20% by default though there is scope to ask Ofgem to amend this threshold by direction. The ASTI framework includes a similar mechanism with a threshold of 5%. We think that the default LOTI threshold has become untenable given how market dynamics have shifted since the outset of RIIO-T2 and the superheated cost escalation experienced on recent major transmission projects. EGL2 demonstrated Ofgem's ability and willingness to respond to changing market dynamics; and, recognise the IJV's (and TO's) levels of absolute cost exposure. We would encourage a consistent application of such flexibility when deciding upon any appropriate adjustment to the thresholds for application of the COAE mechanism (within PA decisions) for future major transmission infrastructure investment projects.

Miscellaneous

We would like to highlight the following further comments which do not relate to any of Ofgem's consultation questions:

- In our PA submission, we stated that it was our understanding that Ofgem will need to modify the definition of "Transmission Area" in the Special Conditions of the SSENT and NGET Licences. This will be required to implement Ofgem's decisions to approve the reinforcement of the transmission system as part of the EGL2 project. We provided proposed modifications to Ofgem in the PA submission document, which we believe are required to: extend the current definition of "Transmission Area" in their respective licences so as to include the subsea corridor that part of the EGL2 link (owned by SSENT and NGET) will pass through; and, include a formal technical definition of that EGL2 link. We understand from Ofgem that they have no objection to the proposed modification to the definition of "Transmission Area" in the TOs' respective Electricity Transmission Licences. There is no reference to this requirement within the current consultation document. However, we understand that Ofgem intend to initiate a statutory consultation in this regard in due course and we look forward to responding to this.
- In their decision on the Final Needs Case (FNC) (issued 8 July 2022), Ofgem confirmed their approval of the Eastern Green Link 2 project FNC. In doing so, they noted that their "approval [was] conditional on, and subject to, material planning consents being obtained for each corresponding Eastern HVDC link." The EGL2 project received the onshore planning consent (for 2km of underground DC and AC cable at Drax) from Selby District Council on 8 August 2023. This consent represented the last material planning consent required to support delivery of the EGL2 project. Ordinarily, in line with Ofgem's Regulatory Reporting Process and the Regulatory Instructions and Guidance (RIGs), SSENT and NGET would submit respective Price Control Deliverable (PCD) reports in July 2024 to request that Ofgem confirms the relevant PCDs are now considered closed. In the interests of efficiency and avoiding duplication of effort, we would appreciate it if Ofgem are able to confirm in writing (e.g. within its Project Assessment determination) that: there is no requirement for either TO to submit a further PCD report; and, they have officially discharged the condition originally attached to their FNC approval.
- We note that the EGL2 consultation does not contain any mention of Ofgem's proposals regarding (amendments to SpC 9.3 of the TOs' licences) on the +/- 5% outturn cost adjustment (relative to allowances) for ASTI projects. SMEs within both TOs continue to engage separately with Ofgem on this topic. We would like to reiterate here that the current draft licence provisions (as at the date

of this response) do not include the opportunity to allow an alternative value to be set where appropriate for different projects. We believe that this should be added and recognise that any alternative value would be set at the Authority's discretion.

We trust that the points in our response below are clear but please do not hesitate to contact us if you would like to discuss further.

Yours sincerely

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