

Providing a greater role for third parties in electricity transmission: Early thinking

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Target Audience: Consumers and their representatives, transmission companies, generators, suppliers, investors, environmental organisations, distribution network companies, government policy makers and other interested parties.

Overview:

This is the first transmission price control to reflect the new RIIO (Revenue = Incentives + Innovation + Outputs) model. RIIO is designed to drive real benefits for consumers; providing network companies with strong incentives to step up and meet the challenges of delivering a low carbon, sustainable energy sector at a lower cost than would have been the case under our previous approach. RIIO puts sustainability alongside consumers at the heart of what network companies do. It also provides a transparent and predictable framework, with appropriate rewards to promote timely investment in the networks.

In our RIIO strategy documents we presented our view that providing an opportunity to secure more cost-effective solutions through the application of competitive processes has the potential to deliver benefits to consumers. Significant investment is required in the onshore electricity transmission network over the coming years and the incumbent transmission companies will need to deliver a substantial build programme in a relatively short time. Having the option to use third parties to deliver, own and operate extensions to the network has the potential to reduce the risk and the cost of this programme. This consultation marks the first step towards the development of this option. Recognising the lead-times associated with code and licence changes, we focus on these elements as a priority.

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Associated Documents

RIIO-T1 Decision paper

- Decision on strategy for the next transmission price control - RIIO-T1
<http://www.ofgem.gov.uk/Networks/Trans/PriceControls/RIIO-T1/ConRes/Documents1/T1decision.pdf>

Links to relevant supplementary annexes

- Decision on strategy for the next transmission price control - RIIO-T1 Tools for cost assessment
<http://www.ofgem.gov.uk/Networks/Trans/PriceControls/RIIO-T1/ConRes/Documents1/T1decisioncosts.pdf>
- Decision on strategy for the next transmission and gas distribution price controls - RIIO-T1 and GD1 Business plans, innovation and efficiency incentives
<http://www.ofgem.gov.uk/Networks/Trans/PriceControls/RIIO-T1/ConRes/Documents1/T1decisionbusplan.pdf>

December RIIO strategy consultation

- Consultation on strategy for the next transmission price control - RIIO-T1 Overview paper (159/10)
<http://www.ofgem.gov.uk/Networks/Trans/PriceControls/RIIO-T1/ConRes/Documents1/RIIO-T1%20overview.pdf>
- Consultation on strategy for the next transmission and gas distribution price controls - RIIO-T1 and GD1 Business plans, innovation and efficiency incentives (159/10)
<http://www.ofgem.gov.uk/Networks/Trans/PriceControls/RIIO-T1/ConRes/Documents1/T1%20and%20GD1%20BP%20prop.pdf>
- Handbook for implementing the RIIO model, October 2010
<http://www.ofgem.gov.uk/Networks/rpix20/ConsultDocs/Documents1/RIIO%20handbook.pdf>

Links to other associated documents

- Consultation on third package unbundling requirements(97/10)
http://www.ofgem.gov.uk/Europe/Documents1/3rd%20pk%20unbundling%20con%20doc_FINAL.pdf

A glossary of terms for all the RIIO-T1 and GD1 documents is on our website:

<http://www.ofgem.gov.uk/Networks/Trans/PriceControls/RIIO-T1/ConRes/Documents1/T1decisiongloss.pdf>

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Summary

In developing the RIIO framework, we considered whether benefits could be achieved through increasing the role competition plays in network regulation. We concluded that, when used appropriately, having the option to allow third parties to develop, own and operate parts of the network could realise significant benefits for consumers.

Last October we communicated our decision to include the option of extending the competition provision of network services in the RIIO framework. We consider this approach has the potential to deliver new network assets at a lower cost to the consumer, through promoting greater innovation and by reducing the costs of project financing and delivery.

However, we are also committed to ensuring that the regulatory framework does not delay critical investment – we will only consider giving third parties a greater role where it will not pose significant risks to timely delivery of critical infrastructure. We also acknowledge that it would only be appropriate to consider the competitive delivery, operation and ownership of network assets when investments are of sufficient size to justify the additional regulatory and industry commitment required to provide for third party delivery. We would also need to be able to clearly define the assets that the third party would be responsible for delivering and operating, which implies the assets would probably not be meshed with other network assets.

In December 2010, building upon the development of the RIIO framework, we presented our initial strategy for the next transmission and gas distribution price controls, RIIO-T1 and GD1. We consulted on our view that our priority should be the development of the option of competitive delivery in the electricity transmission sector. We considered electricity transmission to be the priority given the magnitude of investment required in the electricity transmission sector, and the fact that a significant portion of this investment was likely to meet the criteria for third party delivery. This consultation marks the first step in this process.

We are not making the decision to utilise the competitive option at this time. We would only choose to utilise this option following consultation and the completion of our review of the business plans submitted by the transmission companies. We are more likely to want to utilise the competitive approach where we have concerns that the companies' plans do not represent good value for consumers.

As we develop our thinking in this area, we are committed to working with stakeholders across the industry, along with the investment community and potential developers, and intend to phase our consultation process. As a priority, we will focus on the licence and code changes that will be necessary to recognise the role third parties may play in the delivery of electricity transmission infrastructure. These are facilitating changes and we plan to prioritise these to allow time for these changes to be progressed via the industry processes.

Our present view is that there are two key changes to the licence. First, where the incumbent has undertaken some limited pre-construction works, there is a need to minimise the duplication of this work if third party delivery is selected. Second, we consider that we will need to place obligations on existing licensees to raise changes to the industry codes to facilitate third party involvement.

We also consider the changes required to the industry codes to be small and mainly definitional in nature.

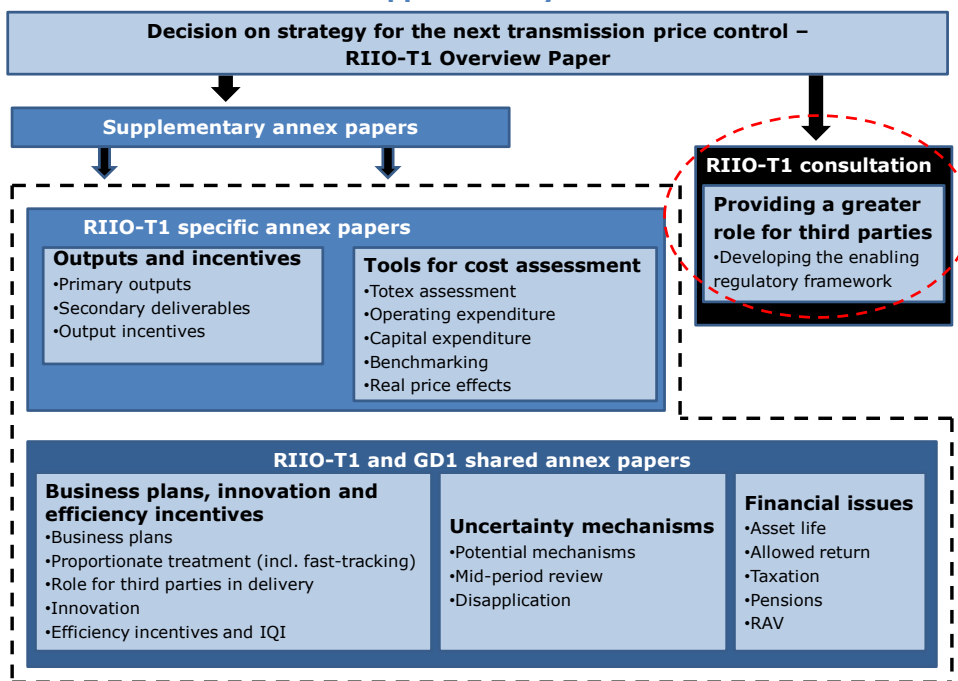
We would welcome the views of stakeholders on our proposed licence and code changes. In the future, we will focus on the development of a fair and transparent process by which the appropriate third party could be selected and the commercial arrangements through which they will realise a return. At this stage, we consider it likely that the process will involve a revenue stream being awarded to a licensee by the Authority following a robust selection process.

1. Introduction

1.1. The next transmission and gas distribution price controls, RIIO-T1 and GD1, will be the first to reflect the new RIIO model. In December 2010, we consulted on our initial strategy for the two price control reviews, and communicated our view that there is a strong case to develop the framework to enable third parties to build, own and operate elements of the electricity transmission network, and that we should work to develop this option as a priority. This consultation marks the start of this work.

1.2. Figure 1 below provides a map of the RIIO-T1 documents, highlighting where this consultation fits within the RIIO package.

Figure 1: This consultation is supplementary to the RIIO decision documents



*Document links can be found in the 'Associated documents' section of this paper.

1.3. Our principal objective is to protect the interests of consumers. Promoting competition can play a key role in protecting consumer interests. Competition already plays an important role in the regulation of network companies, both through comparative regulation and at the extremities of the network. In the case of transmission, companies compete to own and operate offshore transmission assets. In the case of distribution, companies compete to install, own and operate extensions to the gas and electricity distribution networks.

1.4. In developing the RIIO framework, we considered whether benefits could be achieved through increasing the role competition plays in network regulation. We

concluded that the RIIO framework should increase the role competition plays in two key respects.

1.5. First, we would expect companies to undertake and present evidence of market testing as part of their well-justified business plans. We discuss this in detail in the decision paper on Business plans, innovation and efficiency incentives¹, published in parallel with this document.

1.6. Second, we proposed making changes to allow us, in certain circumstances, to consider opening up the delivery of network assets to third parties. We felt that, the involvement of third parties could be beneficial for customers through the exposure of innovative solutions and by providing access to new sources of resources and finance. We noted that the recent tender for offshore transmission projects is expected to deliver significant financial savings over the next 20 years.

1.7. This consultation represents the first step towards the development of the arrangements to support the competitive delivery of onshore electricity transmission assets. We feel the needs case is greatest for this type of asset given the magnitude of investment required over the coming years.

1.8. The focus of this consultation is the establishment of the technical and regulatory framework necessary to enable third party delivery within the sector, which we expect to be realised through changes to licences and codes. We acknowledge that a significant amount of work is required to develop the associated process and commercial arrangements before a project can be subjected to third party delivery and ownership. The development of these arrangements will be the focus of subsequent consultations.

1.9. We are not making the decision to utilise the competitive option at this time. We would only choose to utilise this option following consultation and the completion of our review of the business plans submitted by the transmission companies. We are more likely to want to utilise the competitive option where we have concerns that the companies' plans do not represent good value for consumers.

Structure of the document

1.10. **Chapter 2** of this document sets the scene; presenting an overview of the RIIO framework and specifically the provisions to introduce a greater role for third parties in the delivery of network projects. We present our current thinking on the role we consider third party delivery and ownership can play in transmission and gas distribution sectors, and communicate why we believe the option should be developed within electricity transmission as a priority.

¹ <http://www.ofgem.gov.uk/Networks/Trans/PriceControls/RIIO-T1/ConRes/Documents1/T1decisionbusplan.pdf>

1.11. **Chapter 3** sets out the legislative framework at both a Great Britain (GB) and European level and focuses on the possible impacts of the European Union (EU)'s Third Energy Package. We then set out at a high level our early thinking on the process and commercial arrangements necessary to underpin any competitive process.

1.12. **Chapter 4** presents, for consultation our early thinking on the licence and code modifications that will be required to create a regulatory framework to allow third parties to develop transmission assets. We intend to progress these changes as a priority.

2. Context

Chapter Summary

In this chapter, we present our view that a greater role for third parties in the delivery, ownership and operation of network assets has the potential to realise significant benefits. We provide an overview of the RIIO framework and describe how we arrived at a decision to facilitate a greater role for third parties in the delivery of network projects. We consider the development of these provisions to be a priority within electricity transmission and present our rationale.

Why this is important

1.1. As we set out in our decision on RIIO, we consider that providing an opportunity to secure more cost-effective solutions through the application of competitive processes has the potential to deliver benefits to consumers. This consultation deals specifically with developing the framework necessary for third parties to be able to deliver, operate and own new assets within the onshore electricity transmission sector.

1.2. Significant investment is required within this sector over the coming years and the incumbent transmission companies will need to deliver a substantial build programme in a relatively short time. This programme is materially greater and more complex than experienced in the recent past and there is a risk that the companies will experience resource constraints. The ability to use other parties to deliver critical projects may help to mitigate this risk and a deeper pool of providers may help to spur the development and application of innovative techniques to resolve the challenges faced by the industry.

1.3. We acknowledge that establishing a robust framework to allow new providers to enter the sector will require both regulatory and industry effort. Specifically we must address the risk that a proliferation of providers may result in problems operating a coordinated system, we expect this risk to be mitigated through commercial agreements and technical standards enforced through licences and industry codes. We are also alive to the risk that adoption of a competitive approach results in delay to critical investments - we are committed to ensuring such an approach is only adopted where it will not result in a delay.

Third party delivery and the RIIO framework

RPI-X@20 and the development of the RIIO framework

2.1. Since privatisation of the gas and electricity industry in the late 1980s, we have used regulation based on the RPI-X model. Last July we published the recommendations of the RPI-X@20 project, a fundamental review of this model and the way we regulate network companies in general. On 4 October 2010, following consultation on these recommendations, the Authority launched a new regulatory framework known as RIIO (Revenue = Incentives + Innovation + Output). Under

RIIO, companies will be set an ex ante revenue stream, will be provided with financial and reputation incentives linked to defined outputs and will face encouragement to be innovative. RIIO builds on successful elements that we had developed in regulation under RPI-X and adds new elements. Together this produces a regulatory framework to encourage network companies to meet today's challenges including the transformation to a sustainable energy sector, maintenance of reliable and secure supply and achievement of the above at affordable prices for consumers.

2.2. We are applying the RIIO model for the first time as part of the current transmission and gas distribution price control reviews, known as RIIO-T1 and RIIO-GD1 respectively. The conclusions of these reviews are set to take effect from 1 April 2013. This document is being published as part of the suite of RIIO-T1 documents that make up the March strategy decision on both of these price controls.

Third party delivery and the RIIO framework

2.3. Throughout the RPI-X@20 project, we consulted on whether it would be appropriate to increase the role third parties play in the delivery of network assets. We concluded that it would be appropriate in two key areas:

- During the business planning process where we consider that greater market testing may be required to ensure the efficiency of the business plan.
- Where specific projects are identified as potentially suitable for third party delivery and ownership and are progressed outside of the price control.

2.4. Our early thinking on how the role of third parties could be increased was presented in the 'Handbook for implementing RIIO'² published last October. In our December consultation documents on the RIIO-T1 & GD1 price controls we consulted further on the practical application of these conclusions on the forthcoming price controls. The role we expect market testing to play in the submission of business plans is described in our decision paper on 'Business plans, innovation and efficiency incentives'³ published in parallel with this document.

When would we consider third party delivery?

2.5. The RIIO handbook outlined the criteria that would need to be considered when assessing whether a project would be suitable for third party delivery and ownership. We considered that a competitive approach to delivery and ownership might be appropriate if:

- the project in question is significant in scale and/or cost

² <http://www.ofgem.gov.uk/Networks/rpix20/ConsultDocs/Documents1/RIIO%20handbook.pdf>

³ <http://www.ofgem.gov.uk/Networks/Trans/PriceControls/RIIO-T1/ConRes/Documents1/T1decisionbusplan.pdf>

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- the project involves assets required for expansion of the network that are not meshed with existing assets, or can be defined in such a way that they are not meshed with existing assets
 - giving third parties a greater role in delivery will not pose significant risks to timely delivery, including the timely delivery of emission reduction or renewable targets
 - giving third parties a greater role in delivery will not pose significant risks to the safety, security, integrity and quality of energy services
 - we can demonstrate the expected potential long-term net benefits
 - we are confident that giving third parties ownership of relevant assets will not compromise the legitimate expectations of existing licensees who made investments without knowledge of the possibility of assets potentially being transferred to a third party at a later date and
 - giving third parties a greater role in delivery will be compliant with domestic and relevant EU legislation, including the third package.

Third party delivery across the networks' sectors

2.6. The work required to develop the regulatory framework, as well as the commercial and process arrangements to enable third parties to build, own and operate elements of the networks will need to be undertaken on a sector-specific basis and will involve considerable industry and regulatory commitment. Furthermore, the benefits associated with undertaking this work vary from sector to sector. We consulted in December on whether stakeholders across the sectors considered the development of the enabling regulatory framework to be a priority.

2.7. Stakeholders did not consider the establishment of the enabling regulatory framework to be a priority for gas transmission. We note however, that in light of the changes to the planning process National Grid have recently entered into discussions with industry over the possibility of extending the timelines to deliver additional capacity. We consider third party delivery may have the potential to deliver new infrastructure in a more timely manner and intend to monitor these discussions and potentially consult further on the role of third parties in the sector in the future.

2.8. In the case of gas distribution, stakeholders agreed with our view that it would be impractical for third parties to compete to develop new projects where they are heavily meshed with the existing network, and we do not intend to progress this option any further at this time.

2.9. In the case of electricity transmission, a number of stakeholders agreed with our view that the nature and magnitude of the investment required over the coming years marked this sector out as a priority⁴. Accordingly, it is the establishment of the regulatory framework in this sector that forms the focus of this document. We first set out why we consider electricity transmission to be a priority area for the development of the competitive approach to delivery and ownership.

⁴ A detailed summary of responses to the December consultation can be found in appendix 2.

Why we consider electricity transmission to be a priority

2.10. The demands of the 2020 and 2050 targets on carbon abatement and renewable deployment are likely to impact most significantly on the electricity transmission sector, given the enabling role it plays in connecting and transporting low carbon and renewable energy. We consider the nature of transmission investment to be suitable for third party delivery with a number of projects in the future likely to meet the criteria described earlier in this chapter. Our current view is that third party development, ownership and operation of network assets has the potential to realise benefits for a range of stakeholders.

2.11. Consumers and users of the transmission system could benefit through reduced network charges resulting from lower delivery costs and the increased scope for innovation that third parties could deliver. Additionally, it is possible that in some instances a third party could deliver a project in a more timely manner, particularly where the resources of the incumbent licensees are stretched.

2.12. Integral to the success of any new regime will be its ability to attract investment and new sources of finance. The benefits these new sources of finance could deliver will only be possible if we work closely with the investment community to develop a commercial package that is both attractive to investors and represents genuine value for consumers. There are precedents for this; both internationally and within other sectors and we will look to learn from these experiences. Our engagement with the investment community, both throughout the development of the RIIO proposals, and when developing the offshore regime, indicates that there is an appetite on the part of investors for alternative ways to receive a regulated return.

2.13. A key concern expressed during the development of the RIIO proposals was that allowing third parties to assume responsibility for the delivery and ownership of network assets could lead to delays in the delivery of vital infrastructure. This concern is of particular note given the challenging 2020 and 2050 targets on carbon abatement and renewable generation. We recognise the importance of the timely delivery of network infrastructure. In line with the criteria set out earlier in the chapter, we would only utilise a competitive approach if we could do so without introducing delay to critical investment. But, there may be cases where an incumbent network company is experiencing resource stretch and where the competitive provision of asset delivery could actually result in accelerated delivery timescales.

A further concern expressed during the development of the RIIO proposals was that this new role for third parties could increase uncertainty for investors. In line with the guiding principles of the RIIO framework, we are committed to ensuring the transparency of the process as well as taking forward active stakeholder engagement to ensure the implementation of an effective process.

3. Legislative framework and process

Chapter Summary

This chapter describes the current legislative and industry arrangements within GB that govern the industry, as well as highlighting some of the likely impacts of the EU's Third Energy Package. We then set out for consultation our early thinking on the process and commercial arrangements necessary to underpin any competitive process.

Question 1: In light of DECCs view that "arrangements that allow or require certain activities to be carried out by an ownership unbundled System Operator are consistent with the purposes of the Directive" do stakeholders consider the current separation of duties between transmission licensees and NETSO would constitute any significant barrier to entry to prospective transmission licensees?

Question 2: Do stakeholders consider the existing criteria and process by which an application for a transmission licence is made to represent a barrier to entry? Do stakeholders foresee any risks or concerns with this approach?

Question 3: Do stakeholders agree that it should remain the responsibility of the incumbent transmission licensees to identify the need for future investment?

Question 4: At this early stage, do stakeholders have a view on the most appropriate revenue model for parties granted the right to develop, own, and operate transmission assets through a selection process?

Question 5: Do stakeholders have views on whether an alternative model can be found, and can they suggest alternatives?

Existing arrangements in onshore electricity transmission

3.1. Three Transmission Owners currently hold onshore electricity transmission licences:

- National Grid Electricity Transmission (NGET)
- Scottish Power Transmission Limited (SPTL)
- Scottish Hydro Electric Transmission Limited (SHETL)

3.2. The onshore transmission licences allow these parties to transmit electricity in their authorised areas. The licences also place obligations on the TOs to make transmission services available to the system operator (SO). Along with planning and developing the system - under Section 9 of the Electricity Act 1989 they have an obligation to "develop and maintain ... an efficient, co-ordinated and economical system[s]". They are also obliged to offer and provide connections to generation and demand consumers. Section 4 of the Electricity Act prohibits the activity of transmission in the absence of a licence.

3.3. NGET also perform the role of NETSO (National Electricity Transmission System Operator) across Great Britain. As NETSO, NGET has responsibility for ensuring the

GB electricity transmission network remains in balance and within safe operational limits. It also has a role in processing connection applications from generation and demand consumers.

3.4. In terms of the split of responsibilities, at a high level, the TO takes forward investment and maintenance of the network, while the NETSO has responsibility for day-to-day network operation and for keeping the system within safe operating limits.

3.5. Note: This paper is concerned with proposals for onshore transmission of electricity, being transmission within Great Britain but not transmission within an area of offshore waters of electricity generated by a generating station in offshore waters, as defined in the Electricity Act 1989⁵

European legislation and the third package

3.6. The Third Energy Package of European legislation contains a number of Directives that will shortly be transposed into domestic legislation. Of particular relevance to third party delivery is Directive 2009/72/EC⁶ (the "Directive") concerning common rules for the internal market in electricity. To deliver greater structural separation of networks from generation/production and supply activities, the Directive stipulates that by March 2012 transmission owners and operators across Europe must be certified as compliant with certain unbundling requirements. Whilst the Directive is yet to be transposed into the national legislation within GB, Department of Energy Climate Change (DECC) have recently concluded a consultation on the implementation of the third package⁷ in which they confirmed that the Authority will be responsible for carrying out this certification within GB.

3.7. Article 9 of the Directive provides that, unless one of the other unbundling models applies, all transmission system operators must be fully ownership unbundled⁸. This means that the same person cannot directly or indirectly control a

⁵ Section 6C

(5) "offshore transmission licence" means a transmission licence authorising anything that forms part of a transmission system to be used for purposes connected with offshore transmission

(6) "offshore transmission" means the transmission within an area of offshore waters of electricity generated by a generating station in such an area

(7) "offshore waters" means—

(a) waters in or adjacent to Great Britain which are between the mean low water mark and the seaward limits of the territorial sea; and

(b) waters within an area designated under section 1(7) of the Continental Shelf Act 1964

Section 4(4) "transmission", in relation to electricity, means transmission by means of a transmission system;

"transmission system" means a system which—

(a) consists (wholly or mainly) of high voltage lines and electrical plant, and

(b) is used for conveying electricity from a generating station to a substation, from one generating station to another or from one substation to another.

⁶ <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:211:0055:0093:EN:PDF>

⁷ DECC response - Implementation of the EU Third Internal Energy Package:

<http://www.decc.gov.uk/assets/decc/Consultations/eu-third-package/1163-eu-third-package-gov-response.pdf>

⁸ For the purposes of licensees in Great Britain, we understand this to mean transmission licensees, including offshore transmission licensees and electricity and gas interconnectors.

transmission system or a transmission system operator and also directly or indirectly control or exercise any rights over an undertaking performing electricity generation or gas production or gas or electricity supply⁹. The Directive makes provision for member states not to apply the full ownership unbundling requirements where a transmission system belonged to a vertically integrated undertaking¹⁰ on 3 September 2009. In those cases, the Directive provides alternative models that may be adopted: the Independent System Operator (ISO) model; the Independent Transmission Operator (ITO) model; and a model where the arrangements which were in place on 3 September 2009 guarantee more effective independence of the transmission system operator than the ITO model (an Article 9(9) derogation). Last year the Scottish licensees (SHETL and SPTL) communicated their intention to apply for such a derogation, and we consulted on this issue¹¹. DECC have recently confirmed their intention to make a provision for this derogation in national law, and we expect to make a decision on their application later this year¹². We describe the models in following table:

Table 1: Summary of 3rd package compliant models for TOs

Model	Overview
Full ownership unbundling – required for all licensees unless a derogation is granted as detailed below:	Under this model the same person cannot directly or indirectly exercise control over a transmission system or transmission system operator and directly or indirectly exercise control or any right over an entity performing generation, supply or transmission activities.

Derogations from the requirement for full ownership unbundling: The alternative models are available only where the transmission system belonged to a vertically integrated undertaking on 3 September 2009.

Independent System Operator (ISO) model	The transmission system can continue to belong to the same vertically integrated undertaking. However to mitigate the risk of a conflict of interest, a distinct entity (the ISO) is designated to act as system operator with independent responsibility for tasks including charging, operating, maintaining and developing the transmission system and undertaking investment planning.
Independent Transmission Operator (ITO) model This model is not being made available in GB for electricity transmission	Under this model, the transmission system operator could continue to belong to the same vertically integrated undertaking. However, the designated operator (the ITO) would own the transmission system and would need to act as an independent business with strong “Chinese walls” and an increased role for the regulator.

⁹ DECC have recently confirmed their intention to make provision for a number of exceptions to this, detailed later in this chapter.

¹⁰ In the Directive a “vertically integrated undertaking” means an electricity undertaking or a group of electricity undertakings where the same person or the same persons are entitled, directly or indirectly, to exercise control, and where the undertaking or group of undertakings perform at least one of the functions of transmission or distribution, and at least one of the functions of generation or supply of electricity.

¹¹ http://www.ofgem.gov.uk/Europe/Documents1/3rd%20pk%20unbundling%20con%20doc_FINAL.pdf

¹² This decision is subject to a veto by the European Commission.

Article 9(9) derogation	The arrangements which were in place on 3 September 2009 guarantee more effective independence of the transmission system operator than the ITO model.
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3.8. We will work closely with DECC and the EU Commission to understand the implications of the Directive on increasing the role for third parties in onshore transmission and currently consider there to be a small number of significant interactions on which we would like to communicate our thinking and consult with stakeholders:

3.9. The (Article 12) duties of any prospective TSO: Article 12 of the Directive outlines the tasks each TSO (Transmission System Operator) shall be responsible for (listed in Appendix 2). Under the current arrangements, described previously, National Grid as NETSO discharges a number of these responsibilities across GB. We acknowledge that placing an obligation on a new Transmission licensee to undertake the full suite of Article 12 duties could be considered onerous and inefficient.

3.10. In the conclusion to their consultation on implementation of the third package, DECC communicated that *“arrangements that allow or require certain activities to be carried out by an ownership unbundled System Operator are consistent with the purposes of the Directive”*. Adding *“the Government is not proposing to require all TSOs to carry out all of the TSO tasks set out at Article 12. The Government’s view is that licences already set out the functions relevant to each type of TSO and that it is not necessary to require TSOs to carry out functions that are not relevant to their role”*.

Question 1: In light of DECC’s view that *“arrangements that allow or require certain activities to be carried out by an ownership unbundled System Operator are consistent with the purposes of the Directive”* do stakeholders consider the current separation of duties between transmission licensees and NETSO would constitute any significant barrier to entry to prospective transmission licensees?

3.11. The impacts SHETL and SPTL’s derogation request: In July last year we consulted on the certification of transmission system operators under the Third Package¹³. As part of the consultation we presented our view that, in the context of the offshore regime, it would be doubtful that any acquisition of a physically discrete offshore transmission asset that did not connect to that TSO’s existing network could be considered part of an existing TSO’s network. As such it would constitute a new transmission system and would have to conform to the fully ownership unbundled model. The implication of this for the onshore competitive regime would be that, in the event the Scottish TOs are granted a derogation, they may not be able to develop assets that were not contiguous to their existing transmission network. We intend to consider this matter and the potential impact it could have on the ability of the Scottish licensees to submit proposals to develop assets in England and Wales.

¹³ http://www.ofgem.gov.uk/Europe/Documents1/3rd%20pk%20unbundling%20con%20doc_FINAL.pdf

3.12. As stated earlier, a key element of the Directive is the requirement for any Transmission licensee to be fully unbundled (unless they are certified under the ITO, ISO or derogation models). This means that any new transmission licensees will be precluded from holding interests in generation or supply. However, in conclusion to their recent consultation on the implementation of the third package DECC confirmed their intention to make provision in legislation for the following exceptions:

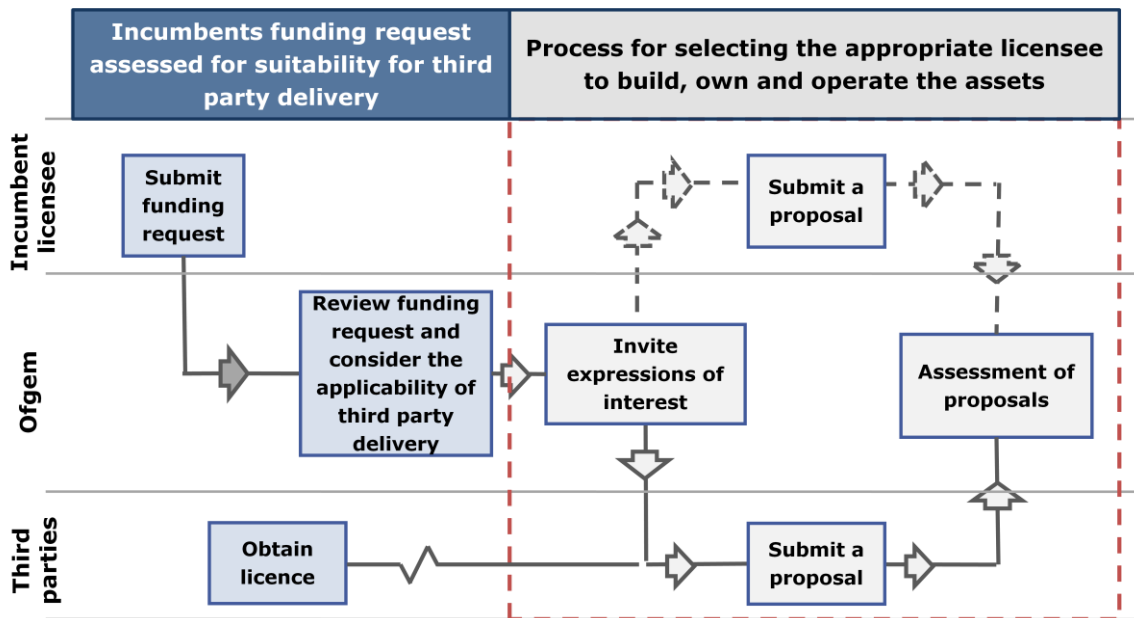
- A de minimis provision to allow transmission operators to carry out small-scale generation and supply to eg supply to tenants; provided that those arrangements do not present a risk of discrimination.
- Generation, production and supply which takes place outside the European Economic Area will not be taken into account.
- Arrangements that will allow testing and limited operation of transmission assets pending transfer to a TSO such as an OFTO.
- Recognition of the interests of debt investors, who may simultaneously hold rights (eg arising from financial covenants) in a number of energy undertakings, and may take control through the exercise of such rights.

Process and commercial arrangements

3.13. We are committed to working with stakeholders to develop governance arrangements that are fair and transparent as we believe this is essential to deliver the benefits described in Chapter 2. Our thinking is at an early stage, but we think it likely that the arrangements will share many characteristics with those developed for the offshore transmission regime.

3.14. One fundamental difference to the offshore regime, however, is that whilst the Authority will ultimately be responsible for determining the party best placed to deliver a project the process will not result in the granting of a licence. Instead, we propose to determine which existing licence holder will be the most appropriate recipient of funding, and therefore a regulated revenue stream after considering submissions from a number of licensees. Figure 2 overleaf illustrates our early thinking on a potential process. The components of this process are described in further detail overleaf.

Figure 2: Illustrative process for allocating a revenue stream for a project which is subject to third party delivery



Components of the process

3.15. **Obtain a Licence:** A consequence of the fact that we will be selecting between licensees when considering the party best placed to deliver a project is that parties will be required to hold a licence in advance of being granted responsibility over elements of the network. Given this, it is likely that their transmission licence will be limited in nature until they take on responsibility for actual transmission assets. To minimise regulatory burden, we plan on developing a “light” licence made up of a reduced set of licence conditions. The nature of this licence is discussed further in Chapter 4.

3.16. The regulations currently governing the applications for electricity transmission licenses¹⁴ set out objective and non-discriminatory criteria for the grant of a licence. We consider them to be fit for purpose and are of the view that they would not constitute any unnecessary barriers to entry.

¹⁴ The Electricity (Applications for Licences, Modifications of and Area and Extensions and Restrictions of Licences) Regulations 2010 provide details of the criteria and process: http://www.legislation.gov.uk/uksi/2010/2154/pdfs/uksi_20102154_en.pdf

Question 2: Do stakeholders consider the existing criteria and process by which an application for a transmission licence is made to represent a barrier to entry? Do stakeholders foresee any risks or concerns with this approach?

3.17. Submission of a funding request and consideration of the applicability of third party delivery: As mentioned earlier in this chapter, under Section 9 of the Electricity Act 1989 transmission licensees have a responsibility to “develop and maintain ... an efficient, co-ordinated and economical system[s]”. We therefore consider it appropriate that existing licensees will continue to undertake investment planning and identify future network projects in relation to their system¹⁵. In Chapter 2 we presented the factors we would take into consideration when determining whether a project is suitable for third party delivery.

Question 3: Do stakeholders agree that it should remain the responsibility of the incumbent transmission licensees to identify the need for future investment?

3.18. Invite expressions of interest: We may consult to understand the appetite amongst third parties to develop the assets and the likelihood that such an approach would realise benefits for consumers in advance of receipt of a full funding submission from the incumbent licensee. In other cases, and where time allows, we may only consult after receipt of a funding request from the incumbent. In either instance, the incumbent would have a further opportunity to submit a project proposal and associated funding request as part of the selection process. Where the incumbent licensee submits a funding request as part of a process, we consider it is likely to be necessary to ring-fence the project from the incumbent licensee’s price control to ensure equal treatment for all parties.

3.19. Assessment of proposals and selection of the successful party: We will implement transparent, objective criteria for the assessment of any proposals submitted by either new or existing transmission licensees. Ultimately, the Authority would make the final decision on the award of a revenue stream. Through this consultation period we plan to develop a suite of criteria against which proposals submitted would be assessed. As with the offshore regime we will consider whether the proposals represent value for money for consumers and ensure that they are fit for purpose. We will therefore work closely with the investment community to develop a commercial package that is both attractive to investors and represents genuine value for consumers.

3.20. Selection of the successful party: The licence conditions of the successful party would have to be updated to reflect their new revenue stream and obligations. Where the successful party is already subject to price controls under the RIIO model, it is likely to be necessary to make specific provisions in the licence for these new assets to ensure the obligations placed on them are the same as they would be for any other party.

¹⁵ this may include having regard to contiguous parts of the system, which are owned and operated by another licensee

Additional commercial considerations

3.21. In addition to the building blocks of the process outlined above there are a number of important commercial considerations that we intend to consult on in detail later in this consultation process. We currently consider there to be two key decisions on which we seek stakeholder's input.

3.22. **Avoiding duplication of pre-construction works:** It is possible that the incumbent licensee will have already undertaken some preconstruction works in advance of our decision to engage with third parties. The preconstruction works are likely to include desktop cost assessments, geological and environmental surveys, along with some of the work required to acquire the necessary consents. In such instances, it would not be desirable for third parties to duplicate this work. In establishing the regulatory framework we consider it likely to be necessary to introduce a change to the incumbent's licence to mitigate this risk. We discuss this in detail in Chapter 4.

3.23. **The nature of the revenue stream:** In part, the benefits of the regime will depend on the nature of the revenue stream we award; we plan on working closely with stakeholders, including the investment community, to develop an approach through which these benefits can be maximised. Two approaches are currently in use within Electricity transmission.

- **The RIIO model (to be employed from April 2013 to onshore Networks).** The key characteristic of this model is that a new price control is carried out periodically (every eight years). At this time of the regulatory review, each element of the price control is subject to review, including the allowed level of return. This model has evolved over the last 20 years as the optimal approach to regulating large network companies.
- **The model in use for the regulation of offshore transmission owners (OFTO).** Under this regime, the OFTOs are awarded a 20-year revenue stream based on their bid for design, build, finance, operation and maintenance of the transmission assets, submitted during the tender process. The approach includes provisions for adjustments to the revenue stream of the OFTO in response to pre-defined events. The approach also includes incentives to maintain high levels of asset availability to limit generator financial losses due to outages.

3.24. Our current view, informed by our experience with the offshore regime, is that the long-term revenue security of the offshore model and the potential for licensees to benefit over an extended period from savings achieved through efficiency and innovation is likely to attract a wider range of investors including those looking to finance discrete projects. This may mean that we will ultimately arrive at a model that more closely reflects the approach currently being employed offshore, however we are committed to consulting further on this crucial element of the design in detail in future consultation documents.

Question 4: At this early stage, do stakeholders have a view on the most appropriate revenue model for parties granted the right to develop, own, and operate transmission assets through a selection process?

Alternative approaches

3.25. The building blocks of the arrangements described on the previous pages relate specifically to the RIIO model through which third parties will assume responsibility for the build, ownership and operation of network assets. We are committed to taking forward the enabling code and licensing changes to facilitate this model, however we also acknowledge that under certain circumstances there may be scope for alternative approaches to third party involvement to realise similar benefits. It is possible that these alternative arrangements may involve less operational complexity.

3.26. For example, it may be possible to develop an alternative approach that delivers some of the benefits associated with third party delivery, operation and ownership of network assets but does not require third parties to participate in transmission activities. During the RPI-X project, we identified the ability to realise a lower rate of return through attracting new investment as a potentially significant driver of consumer benefit; we based this assessment on learning from the offshore transmission regime and the strong interest investors signalled in alternative ways to invest in regulated networks. We consider it may be possible to work with the existing transmission licensees to develop a model under which consumers can benefit from exposure to these reduced financing costs but the responsibility for delivery, operation and ownership of new network assets remains with the existing licensees.

Question 5: Do stakeholders have views on whether an alternative model can be found, and can they suggest alternatives?

Scope of this consultation and interactions with RIIO

3.27. We acknowledge that a great deal of work must be done before a project can be considered for third party delivery, and we are committed to working with stakeholders on this throughout the consultation process.

3.28. This paper focuses on those decisions that will need to be made with respect to the licensing and code changes to develop the enabling regulatory framework.

3.29. Our aim is to ensure that the licensing and code changes are in place by the end of 2011, when we will have completed our review of the Business Plans submitted by the transmission companies.

4. Implementation of the regulatory framework

Chapter summary

This chapter outlines the initial changes to the regulatory framework required to facilitate third party development, operation and ownership of transmission assets. We present our view of the changes that we consider will be required to the industry codes, and consult on two new licence conditions to avoid the duplication of pre-construction works and to ensure the necessary code changes are progressed via the industry process. We also present our early thinking on the practical implications of the requirement for third parties to hold a transmission licence before we can consider funding requests from them.

CHAPTER: Four

Question 1: We request stakeholder's views on how a fair and transparent process to avoid the duplication of pre-construction works may operate?

Question 2: We would welcome stakeholder views on the level of amendments that are likely to be required to the STC to facilitate third parties?

Question 3: We would welcome stakeholder views on the level of amendments that are likely to be required to the SQSS to facilitate third parties?

Question 4: We would welcome stakeholder views on the level of amendments that are likely to be required to the Grid Code to facilitate third parties?

Question 5: We would welcome stakeholder views on the level of amendments that are likely to be required to the CUSC to facilitate third parties?

Question 6: We welcome stakeholder views on the appropriate principles through which we should define the conditions that make up the "light" transmission licence?

Licence and code changes to facilitate third parties

4.1. In order to facilitate a greater role for third parties we consider it necessary for the existing arrangements to change in two main areas:

- A new standard licence condition will need to be developed that will apply to all transmission licensees to provide a mechanism by which, in the event that a third party is selected to undertake a project, the duplication of any pre-construction work can be kept to a minimum.
- Some limited changes will need to be made to the existing industry codes to recognise the role of third parties in the onshore electricity transmission system. Our initial thinking is that changes are required to the following three industry documents with which new licensees would be required to comply:
 - System Operator-Transmission Owner Code (STC)
 - System Quality and Security Standard (SQSS)
 - Grid Code

We also anticipate amendments will be required to the CUSC (Connection and use of system code) to recognise the role of third parties.

Avoiding duplication of preconstruction works

4.2. Under the current arrangements, responsibility for the delivery of assets to meet the needs of system users is defined on a geographical basis; as such, there is no reason for multiple licensees to duplicate pre-construction works. We recognise that with the introduction of a greater role for third parties in delivery, there is a risk that, in some instances, responsibility for the delivery of assets will be granted to a third party after the incumbent has undertaken some initial work. This means that the incumbent licensee may have incurred costs on these pre-construction works. We consider it important to introduce arrangements to avoid duplication of this work and fair recovery of these costs, although we are also conscious that reliance on these pre-construction works may stifle innovation since any party adopting a different approach will have to undertake an increased level of additional pre-construction work.

4.3. When considering how such arrangements may work it is important to consider the accounting treatment of these works along with the means through which they are funded. We must develop a framework that is fair to both the party who initially undertook the work and any parties looking to make use of it. We are committed to developing a framework that also protects the consumer from unnecessary overfunding or funding the same works twice. We consider there to be two methods through which this could be achieved:

4.4. The efficient costs of the pre-construction works are recovered by the developing party: Under this approach the party developing the assets would continue to receive revenue in respect of pre-construction works, most likely through a regulated return on the efficient value of these works or assets. As a condition of the receipt of this revenue, the developing party would be required to make these works available to a third party. We would place an obligation to that effect on transmission licensees through the development of a new standard licence condition. This licence condition would be a standard condition and therefore apply equally to incumbent and new licensees, though we expect it to be unlikely that we would need to compel a new licensee to share these works.

4.5. The advantage of this approach is that these works can be made available to a number of alternate licensees as a basis of their funding submissions, which is likely to reduce the risk and cost associated with these submissions; risks and costs that are likely to be ultimately borne by the consumer.

4.6. The third party pays for these pre-construction works: Under this model, the third party will purchase the assets from the incumbent licensee. These assets will then be removed from the original party's costs and form a cost for the third party. Again, we propose that, if this option is selected it is provided for through a new standard licence condition that would be applicable to all transmission licensees. Although we would expect the two parties to reach a bilateral agreement for the

transfer of these assets, if the two parties cannot agree on the terms of the transfer, the Authority could determine the basis of the transfer.

4.7. These two options represent different ends of a spectrum within which the optimal approach is likely to exist. For example, it could be possible for all third parties expressing an interest to be required to fund, collectively the pre-construction works. We wish to understand the views of stakeholders on this issue.

Question 1: We request stakeholder's views on how a fair and transparent process to avoid the duplication of pre-construction works may operate?

Changes to industry codes

4.8. The industry codes and agreements set out the contractual obligations and relationships that underpin the electricity industry. With the potential introduction of new parties it is important to ensure that they are fit for purpose.

4.9. We do not anticipate the industry codes will require significant amendment to recognise the role of new transmission licensees, and the amendments that are required are likely to be mainly definitional. This section summarises our early thinking on the changes that are likely to be required to each of the codes.

4.10. Existing transmission companies are obliged directly via their licence to comply with the STC and the SQSS, further provisions are made within the STC to compel the licensee to adhere to the Grid code. We consider minor changes will also be required to the CUSC to recognise the role of third parties. There are precedents here with the introduction of the offshore transmission regime and the necessary changes to the codes. We have included details of these changes in appendix 5, and below present a summary of these codes and the changes that are likely to be required to facilitate third parties:

4.11. **STC:** The STC defines the high level relationship between the NETSO and the transmission licensees. It obliges transmission licensees to provide services to the NETSO, along with collaborating on transmission outage planning and joint investment planning. We consider some minor definitional changes to the existing code are likely to be needed to ensure their applicability to new transmission licensees. Beyond this, we do not envisage any significant changes to the STC will be required. The existing provisions related to governance, transmission services, planning, payments and billing, communications and dispute resolution are relatively generic and we consider it likely they will be equally applicable to new as well as existing licensees.

Question 2: We would welcome stakeholder views on the level of amendments that are likely to be required to the STC to facilitate third parties?

4.12. **SQSS:** The SQSS defines a set of minimum criteria and methodologies that transmission licensees must meet in the planning and operation of the electricity transmission system. Within the SQSS there are a number of specific references to

NGET, SPTL and SHETL which largely relate to the areas in which they operate and the differences in terms of technical specification of their respective assets. Our current thinking is that these provisions would not need to be amended. However, some minor changes to the existing definitions may be needed to ensure that the code is applicable to new transmission licensees.

Question 3: We would welcome stakeholder views on the level of amendments that are likely to be required to the SQSS to facilitate third parties?

4.13. **Grid Code:** The function of the Grid code is to ensure the development, maintenance and operation of an efficient and economic electricity transmission system, along with facilitating competition in generation and supply, and promoting Security of Supply. We anticipate that to recognise a role for new transmission licensees a number of definitional changes are required, for example the term 'onshore transmission licensee' used throughout the code are defined specifically to refer to specifically to NGET, SPTL or SHETL.

Question 4: We would welcome stakeholder views on the level of amendments that are likely to be required to the Grid Code to facilitate third parties?

4.14. **CUSC:** The CUSC constitutes the contractual framework for connection to, and use of, the GB electricity transmission system. The code makes specific reference to the existing licensees in a number of places, for example, when setting out the methodology NGET will use to levy charges on behalf of NGET, SPTL & SHETL. We anticipate these references would need to be updated to reflect a role for future licensees.

Question 5: We would welcome stakeholder views on the level of amendments that are likely to be required to the CUSC to facilitate third parties?


4.15. There are a number of ways the changes to the industry codes described above could be progressed, but consider it most likely that this will be achieved through placing a licence obligation on the existing onshore transmission licensees to raise and progress these changes.

Rights and responsibilities of new licensees

4.16. As we discussed in Chapter 3, the Authority will be responsible for granting the revenue stream to develop certain assets, to the most appropriate licensee. As consequence, parties submitting a funding request must be in possession of a transmission licence, which for the purposes of this document we are referring to as a "light licence", reflecting the fact that, until they have been activated, the provisions of this licence will be less extensive than the conditions which apply to NGET, SPTL and SHETL.

4.17. Figure 3 below outlines our early thinking on the licence conditions and code provisions it would be appropriate to impose on a licensee, both before and after they have been selected to develop parts of the transmission network.

Figure 3: Licence conditions and applicable codes are dependent upon the responsibilities of the licensee



Stage	“light” licence	Full transmission licence
Licence contents	<p>Standard conditions: A minimal set to impose only these obligations that are appropriate at this stage and serve to protect consumers and other parties within the industry</p> <p>Special Conditions: reflect the lack of an asset base and authorised transmission area</p>	<p>Standard conditions: Full suite including those ensuring compliance with industry codes</p> <p>Special Conditions: Reflect their asset base, revenue stream, incentives and responsibilities</p>
Applicable codes	none	<p>STC : System Operator (SO)-Transmission Owner (TO) code</p> <p>SQSS: GB System Quality and Security Standard</p> <p>Note – through the SQSS the licensee will also be required to abide by the grid code</p>

“Light” licence

4.18. The transmission licence is made up of both standard and special conditions. Special licence conditions apply to a particular licensee and are used to place obligations on a party that are specific to them. For example, the special conditions include details of the revenue a licensee is eligible to receive or the uncertainty mechanisms by which this revenue may adjust.

4.19. Standard licence conditions typically apply to all licensees of a particular type. A number of these standard conditions place an obligation on the licensee to comply with industry codes, for example, Standard Condition D3 places such an obligation on a transmission licensee to plan and develop their network in line with the SQSS.

4.20. When a licence is granted in advance of a licensee assuming responsibility for elements of the transmission system, we consider it appropriate that their rights and responsibilities are defined in line with the following principles:

- the obligations do not constitute a disproportionate burden
- consumers and other parties in the industry are protected.

4.21. We therefore expect the light licence to only include limited provisions to meet these principles. We propose to set out in more detail the terms of the light licence in

our next consultation as we set out further thinking on the process around involving third parties in delivery.

Question 6: We welcome stakeholder views on the appropriate principles through which we should define the conditions that make up the “light” transmission licence?

Full transmission licence

4.22. Once we have selected a transmission licensee to develop certain assets and receive the associated revenue stream it will be necessary to increase the set of conditions with which they must comply. A determinant of these conditions will be the commercial framework which we will decide upon in subsequent consultations. We expect a model similar to offshore transmission will be developed, but this will be the subject of further consultation.

5. Next steps

This chapter sets out our proposed way forward for the implementation of greater competition into electricity transmission.

5.1. We would welcome responses to this consultation by 18 May 2011. Upon receipt of these responses and following further stakeholder engagement we plan on issuing a 'minded-to' decision in the summer. This will represent the start of our formal consultation on a set of proposed licence changes as well detailing how we intend to progress the code changes.

Appendices

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A glossary of terms for all the RIIO-T1 and GD1 documents is on our website:

<http://www.ofgem.gov.uk/Networks/Trans/PriceControls/RIIO-T1/ConRes/Documents1/T1decisiongloss.pdf>

Appendix 1 - Consultation Response and Questions

1.1. Ofgem would like to hear the views of interested parties in relation to any of the issues set out in this document.

1.2. We would especially welcome responses to the specific questions which we have set out at the beginning of each chapter heading and which are replicated below.

1.3. Responses should be received by 18 May 2011 and should be sent to:

RIIO.T1@ofgem.gov.uk

1.4. Unless marked confidential, all responses will be published by placing them in Ofgem's library and on its website www.ofgem.gov.uk. Respondents may request that their response is kept confidential. Ofgem shall respect this request, subject to any obligations to disclose information, for example, under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004.

1.5. Respondents who wish to have their responses remain confidential should clearly mark the document/s to that effect and include the reasons for confidentiality. It would be helpful if responses could be submitted both electronically and in writing. Respondents are asked to put any confidential material in the appendices to their responses.

1.6. Next steps: Having considered the responses to this consultation, Ofgem intends to further consult on the detailed commercial and governance design decisions. Any questions on this document should, in the first instance, be directed to:

Gareth Walsh
Electricity Transmission
9 Millbank
London
SW1P 3GE
0207 901 1867
Gareth.Walsh@Ofgem.gov.uk

CHAPTER: Three

Question1: In light of DECCs view that "arrangements that allow or require certain activities to be carried out by an ownership unbundled System Operator are consistent with the purposes of the Directive" do stakeholders consider the current separation of duties between transmission licensees and NETSO would constitute any significant barrier to entry to prospective transmission licensees?

Question 2: Do stakeholders consider the existing criteria and process by which an application for a transmission licence is made to represent a barrier to entry? Do stakeholders foresee any risks or concerns with this approach?

Question 3: Do stakeholders agree that it should remain the responsibility of the incumbent transmission licensees to identify the need for future investment?

Question 4: At this early stage, do stakeholders have a view on the most appropriate revenue model for parties granted the right to develop, own, and operate transmission assets through a selection process?

Question 5: Do stakeholders have views on whether an alternative model can be found, and can they suggest alternatives?

CHAPTER: Four

Question 1: We request stakeholder's views on how a fair and transparent process to avoid the duplication of pre-construction works may operate?

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Question 4: We would welcome stakeholder views on the level of amendments that are likely to be required to the Grid Code to facilitate third parties?

Question 5: We would welcome stakeholder views on the level of amendments that are likely to be required to the CUSC to facilitate third parties?

Question 6: We welcome stakeholder views on whether these are the most appropriate principles through which we should define the conditions that make up the "light" transmission licence?

Appendix 2 – Responses to the RIIO December consultation

1.7. In December we consulted with stakeholders on our view that the case to develop the framework to enable third parties to compete to develop and own elements of the electricity transmission network is significant, and that we should work to develop this option as a priority.

1.8. We received a number of responses in favour of the proposal. An environmental stakeholder in support of our proposal suggested a number of projects they considered to be candidates for third party delivery, whilst an energy supplier also registered support for our proposals noting that it could be applied to services, specifically the provision of IT systems and services. At this stage, we are concentrating on establishing the enabling regulatory framework and are not looking at the suitability of particular projects for third party delivery. Furthermore, through this consultation we are only considering a role for third parties in the build, ownership and operation of network assets. Although, as part of a well justified business plan, where appropriate, we would expect network companies to demonstrate evidence of market testing. We acknowledge that, under certain circumstances outsourcing of operations can deliver benefits but do not want to suggest that some business models (e.g. with all activities outsourced) are, in principle, better than others.

1.9. Existing transmission licensees highlighted a number of risks with the approach including risks to the timely delivery of infrastructure and the potential impacts on security of supply as well as concerns regarding fragmentation of the network and loss of coordinated development. We acknowledge that if the correct governance arrangements are not in place there is a real risk to the timely delivery of infrastructure and are committed to working with stakeholders throughout this consultation to develop arrangements to mitigate this risk. Furthermore, as we highlight in this consultation, consideration of timely delivery would be a key determinant of whether we open up a project to third party delivery.

1.10. One respondent requested that an evidence based impact assessment be carried out. We note that during RPI-X@20, we undertook a high-level impact assessment of these proposals. We will consider whether it is appropriate to undertake an impact assessment later in this consultation process. We are committed to assessing the benefits and the risks of allowing third parties to develop assets on a project-by-project basis.

Appendix 3 – The Authorities powers and duties

1.1. Ofgem is the Office of Gas and Electricity Markets which supports the Gas and Electricity Markets Authority (“the Authority”), the regulator of the gas and electricity industries in Great Britain. This appendix summarises the primary powers and duties of the Authority. It is not comprehensive and is not a substitute to reference to the relevant legal instruments (including, but not limited to, those referred to below).

1.2. The Authority's powers and duties are largely provided for in statute (such as the Gas Act 1986, the Electricity Act 1989, the Utilities Act 2000, the Competition Act 1998, the Enterprise Act 2002 and the Energy Acts of 2004, 2008 and 2010) as well as arising from directly effective European Community legislation.

1.3. References to the Gas Act and the Electricity Act in this appendix are to Part 1 of those Acts.¹⁶ Duties and functions relating to gas are set out in the Gas Act and those relating to electricity are set out in the Electricity Act. This appendix must be read accordingly.¹⁷

1.4. The Authority's principal objective is to protect the interests of existing and future consumers in relation to gas conveyed through pipes and electricity conveyed by distribution or transmission systems. The interests of such consumers are their interests taken as a whole, including their interests in the reduction of greenhouse gases and in the security of the supply of gas and electricity to them.

1.5. The Authority is generally required to carry out its functions in the manner it considers is best calculated to further the principal objective, wherever appropriate by promoting effective competition between persons engaged in, or commercial activities connected with,

- the shipping, transportation or supply of gas conveyed through pipes;
- the generation, transmission, distribution or supply of electricity;
- the provision or use of electricity interconnectors.

1.6. Before deciding to carry out its functions in a particular manner with a view to promoting competition, the Authority will have to consider the extent to which the interests of consumers would be protected by that manner of carrying out those functions and whether there is any other manner (whether or not it would promote competition) in which the Authority could carry out those functions which would better protect those interests.

1.7. In performing these duties, the Authority must have regard to:

¹⁶ Entitled “Gas Supply” and “Electricity Supply” respectively.

¹⁷ However, in exercising a function under the Electricity Act the Authority may have regard to the interests of consumers in relation to gas conveyed through pipes and vice versa in the case of it exercising a function under the Gas Act.

-
- the need to secure that, so far as it is economical to meet them, all reasonable demands in Great Britain for gas conveyed through pipes are met;
 - the need to secure that all reasonable demands for electricity are met;
 - the need to secure that licence holders are able to finance the activities which are the subject of obligations on them¹⁸; and
 - the need to contribute to the achievement of sustainable development.

1.8. In performing these duties, the Authority must have regard to the interests of individuals who are disabled or chronically sick, of pensionable age, with low incomes, or residing in rural areas.¹⁹

1.9. Subject to the above, the Authority is required to carry out the functions referred to in the manner which it considers is best calculated to:

- promote efficiency and economy on the part of those licensed²⁰ under the relevant Act and the efficient use of gas conveyed through pipes and electricity conveyed by distribution systems or transmission systems; protect the public from dangers arising from the conveyance of gas through pipes or the use of gas conveyed through pipes and from the generation, transmission, distribution or supply of electricity; and secure a diverse and viable long-term energy supply, and shall, in carrying out those functions, have regard to the effect on the environment.

1.10. In carrying out these functions the Authority must also have regard to:

- the principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed and any other principles that appear to it to represent the best regulatory practice; and
- certain statutory guidance on social and environmental matters issued by the Secretary of State.

1.11. The Authority may, in carrying out a function under the Gas Act and the Electricity Act, have regard to any interests of consumers in relation to communications services and electronic communications apparatus or to water or sewerage services (within the meaning of the Water Industry Act 1991), which are affected by the carrying out of that function.

1.12. The Authority has powers under the Competition Act to investigate suspected anti-competitive activity and take action for breaches of the prohibitions in the legislation in respect of the gas and electricity sectors in Great Britain and is a designated National Competition Authority under the EC Modernisation Regulation²¹ and therefore part of the European Competition Network. The Authority also has

¹⁸ Under the Gas Act and the Utilities Act, in the case of Gas Act functions, or the Electricity Act, the Utilities Act and certain parts of the Energy Acts in the case of Electricity Act functions.

¹⁹ The Authority may have regard to other descriptions of consumers.

²⁰ Or persons authorised by exemptions to carry on any activity.

²¹ Council Regulation (EC) 1/2003.

concurrent powers with the Office of Fair Trading in respect of market investigation references to the Competition Commission.

Appendix 4 – Article 12: Tasks of TSOs

The tasks set out in Article 12 of the Directive 2009/72/EC concerning the common rules for the internal market in electricity:

- a) ensuring the long-term ability of the system to meet reasonable demands for the transmission of electricity, operating, maintaining and developing under economic conditions secure, reliable and efficient transmission systems with due regard to the environment;
- b) ensuring adequate means to meet service obligations;
- c) contributing to security of supply through adequate transmission capacity and system reliability;
- d) managing electricity flows on the system, taking into account exchanges with other interconnected systems. To that end the transmission system operator shall be responsible for ensuring a secure, reliable and efficient electricity system and, in that context, for ensuring the availability of all necessary ancillary services, including those provided by demand response, insofar as such availability is independent from any other transmission system with which its system is interconnected;
- e) providing to the operator of any other system with which its system is interconnected sufficient information to ensure the secure and efficient operation, coordinated development and interoperability of the interconnected system;
- f) ensuring non-discrimination as between system users or classes of system users, particularly in favour of its related undertakings;
- g) providing system users with the information they need for efficient access to the system; and
- h) collecting congestion rents and payments under the inter-transmission system operator compensation mechanism, in compliance with Article 13 of Regulation (EC)No 714/2009, granting and managing third-party access and giving reasoned explanations when it denies such access, which shall be monitored by the national regulatory authorities; in carrying out their tasks under this Article transmission system operators shall primarily facilitate market integration.

Appendix 5 – Changes required to the relevant industry codes

This appendix outlines our initial thoughts on the changes required to the existing industry codes to facilitate new transmission licensees:

Proposed changes to the STC

Section of the code	Overview of proposal
Governance (Section B)	<ul style="list-style-type: none"> Paragraph 6.7.3 sets out that, at committee meetings, the three existing licensees NGET, SPT and SHETL shall each have one vote. <p><i>The code would need to be amended to reflect the potential role of new licensees</i></p>
Planning coordination (Section D)	<ul style="list-style-type: none"> Part 1 paragraph 2.1: Includes a requirement to develop and maintain an investment plan for this year and the coming six financial years. <p><i>It would seem sensible to replicate the OFTO requirement for new licensees to develop and maintain an investment plan where the licensee intends to make changes to its transmission system. We will address this when we consider governance arrangements later in the process.</i></p>
Code Procedures (Schedule 2)	<p><i>The definitions refer to existing licensees and need to be amended to recognise the potential role of new transmission licensees.</i></p>

Proposed changes to the SQSS

Section of the code	Overview of proposal
Terms and definitions (Section 11)	<ul style="list-style-type: none"> The definition of 'onshore transmission licensee' refers specifically to 'NGET, SPT and SHETL'. <p><i>This definition would need amending to recognise the potential role of new transmission licensees. This would ensure the applicability of the definition of 'transmission licensee' as it is defined by reference to 'onshore transmission licensee'</i></p>

Proposed Changes to the Grid code

Section of the code	Overview of proposal
Glossary and definitions	<ul style="list-style-type: none"> ▪ The term 'relevant transmission licensee' is in use throughout the code, and refers specifically to SPT and SHETL. ▪ The definition of 'onshore transmission licensee' refers specifically to 'NGET, SPT or SHETL' ▪ The terms 'E&W transmission system', 'Scottish transmission system', 'transmission site' refer to NGET, SPT and SHETL transmission systems specifically <p><i>Definitions would need to be amended to recognise the potential role of new transmission licensees.</i></p>

Proposed Changes to the CUSC

Section of the code	Overview of proposal
Interpretations and definitions (Section 11) Exhibit O (interface agreements)	<ul style="list-style-type: none"> ▪ The definition of 'relevant transmission licensee' refers to SPTL, SHETL and OFTOs. ▪ The definition of 'transmission licences' refers to licences granted to NGET, SPTL and SHETL. <p><i>Definitions would need to be amended to recognise the potential role of new transmission licensees.</i></p>
Section 2, Section 5 and Section 6	<ul style="list-style-type: none"> ▪ Provisions in these sections require NGET to undertake activities related to connection sites in England and Wales, and SPTL and SHETL carry out such activities in Scotland. ▪ These provisions relate to safety rules, interface agreements, disconnection and equipment use. <p><i>As part of the governance arrangements we will determine the appropriate party to undertake these activities, and this will need to be reflected in the code.</i></p>
Section 14 (charging methodologies)	<ul style="list-style-type: none"> ▪ Outlines that the methodology NGET will use to levy charges for the use of the GB transmission system will be on behalf of NGET, SPTL and SHETL. <p><i>Propose to make changes to the definitions to recognise the responsibilities of new transmission licensees.</i></p>

Appendix 6 – Feedback questionnaire

1.1. Ofgem considers that consultation is at the heart of good policy development. We are keen to consider any comments or complaints about the manner in which this consultation has been conducted. In any case we would be keen to get your answers to the following questions:

1. Do you have any comments about the overall process, which was adopted for this consultation?
2. Do you have any comments about the overall tone and content of the report?
3. Was the report easy to read and understand, could it have been better written?
4. To what extent did the report's conclusions provide a balanced view?
5. To what extent did the report make reasoned recommendations for improvement?
6. Please add any further comments?

1.2. Please send your comments to:

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