

Consultation

Consultation on our views on Early Competition in onshore electricity transmission networks

Publication date: 03/08/2021

Contact: Thomas Johns, Senior Manager

Team: RIIO Electricity Transmission Development

Response deadline: 14/09/2021

Tel: 020 7901 7046

Email: RIIOElectricityTransmission@ofgem.gov.uk

We are consulting on our views on the development of early competition in onshore electricity transmission networks. We would like views from people with an interest in the development of electricity network solutions, technical and commercial innovation, and competing for the design, construction and operation of solutions to solve network problems. The consultation closes on 14/09/2021. We particularly welcome responses from potential bidders in early competition processes and network companies. We would also welcome responses from other stakeholders and the public.

This document outlines the scope, purpose and questions of the consultation and how you can get involved. Once the consultation is closed, we will consider all responses. We want to be transparent in our consultations. We will publish the non-confidential responses we receive alongside a decision on next steps on our website at [Ofgem.gov.uk/consultations](https://www.ofgem.gov.uk/consultations). If you want your response – in whole or in part – to be considered confidential, please tell us in your response and explain why. Please clearly mark the parts of your response that you consider to be confidential, and if possible, put the confidential material in separate appendices to your response.

© Crown copyright 2021

The text of this document may be reproduced (excluding logos) under and in accordance with the terms of the [Open Government Licence](#).

Without prejudice to the generality of the terms of the Open Government Licence the material that is reproduced must be acknowledged as Crown copyright and the document title of this document must be specified in that acknowledgement.

Any enquiries related to the text of this publication should be sent to Ofgem at: 10 South Colonnade, Canary Wharf, London, E14 4PU. Alternatively, please call Ofgem on 0207 901 7000.

This publication is available at www.ofgem.gov.uk. Any enquiries regarding the use and re-use of this information resource should be sent to: psi@nationalarchives.gsi.gov.uk

Contents

Executive summary	4
1. Introduction	8
2. Early Competition context and overview	13
3. ESO's Early Competition Plan	19
4. Identifying which projects are suitable for Early Competition	23
5. Roles and Responsibilities within Early Competition	35
6. Tender process and commercial model	57
7. Next Steps.....	73
Appendices.....	74

Executive summary

Early Competition in RIIO-2

Competition in the design and delivery of energy networks is a central aspect of our RIIO-2 price controls. Competition has a key role to play in driving innovative solutions and efficient delivery that can help us meet our decarbonisation targets at the lowest cost to consumers.

Early competition refers to a competition, to determine a solution to a need on the network, that is run before detailed design of the preferred solution has been carried out. In our May 2019 RIIO-2 Sector Specific Methodology Decision (**SSMD**), we requested that the Electricity System Operator (**ESO**) work on a plan for early competition alongside its RIIO-2 Business Plan.

In April 2021 the ESO published its final Early Competition Plan (**ECP**). This consultation summarises our views on early competition, including the ECP's findings, alongside an Impact Assessment that considers the case for further developing early competition so it can be ready to be used in the design and delivery of solutions to meet the needs on the electricity transmission network.

What this consultation covers

Having reviewed the ESO's ECP proposals, we consider it appropriate at this time to set out our views on the work undertaken by the ESO within its ECP, and how we propose to work towards developing a model of early competition within the onshore electricity transmission sector that would be ready for implementation. We recognise that certain details such as the commercial model available to successful bidders, and detailed tender process will not be able to be fully developed until the key roles and responsibilities within early competition have been identified and allocated. For this reason, our consultation questions focus on key areas relating to the work required to identify which parties should carry out the relevant roles within early

competition, and the proposed process for identifying which projects¹ are most likely to deliver benefits for consumers through the application of early competition.

Specifically, this consultation sets out our views with regards to the following key points from the ESO's ECP:

- The process followed to determine whether specific projects should progress to an early competition tender process
- The criteria that should be used to identify projects from this process that are suitable for early competition
- The high-level tender policy and process arrangements and the commercial model applied to successful bidders
- The key roles that would be played within early competition and the parties best placed to play those roles.

Summary of our views on early competition

Overall we consider that the ESO has done a good job in engaging with a range of stakeholders in order to develop a coherent set of proposals as part of its ECP. We consider (as supported by our accompanying Impact Assessment) that the continued development of the arrangements to allow early competition in electricity transmission represents good value for money for consumers as it is relatively low regret, whilst the potential savings and other benefits (for example in terms of innovation) over the longer-term may be significant. We also consider that early competition, if implemented appropriately, has an important role to play in future network planning and could be an important tool through which the ESO, and/or any Future System Operator (**FSO**) resulting from the current consultation², could deliver benefits to consumers.

¹ For the purposes of this document, a "project" under early competition refers to the indicative solution to a network requirement that would be used to set the terms of the required deliverable of the early competition tender process. Indicative solutions can be based on a TO design, an alternative design identified in the ESO's assessment of Alternative Options as part of the NOA methodology, or a design that is identified through the Interested Persons process

² <https://www.gov.uk/government/consultations/proposals-for-a-future-system-operator-role>

In terms of the model proposed by the ESO in the ECP, we consider that the tender process and market offerings available to successful bidders are reasonable overall and we do not have any immediate concerns at this stage in their development, acknowledging that further work will be needed on these ahead of future implementation. We agree with the distribution of roles and responsibilities suggested by the ESO in the ECP. Subject to this being in alignment with the FSO project and underpinning legislation and BEIS consultation on appointment factors for this role, we agree that based on current market arrangements the ESO, as the “**Procurement Body**”³, is likely to be best placed to run early competitions.

The process proposed by the ESO for identifying network needs that are suitable for early competition appears sensible and logical. We consider that it fits well within existing network design arrangements and processes, but consider the exact configuration of the proposed criteria used to identify network interventions that are suitable for early competition will require further consideration before we reach a final decision. We would also like the ESO to expand on its thinking around how the benefits of competition and innovation can be incorporated into the design process at an earlier stage. This could be through either a greater role for non-TO parties in the early scoping of indicative solutions, as well as considering, as the early competition model evolves, whether there will be certain circumstances where the competition could start at an earlier stage than the ESO proposes in its ECP. We also think its important for the ESO to set out additional practical detail for stakeholders on how the proposed early competition model will differ and/or interact with the existing pathfinder processes.

Next Steps

Following consideration of responses to this consultation, we expect to confirm whether early competition will be implemented within the RIIO-2 arrangements, and if so reach our minded-to decision on both who should carry out each key role within early competition and what the process for identifying suitable projects for early competition should be. As referenced in our May 2021 Update on early competition⁴, we have agreed with the ESO proposal for it to continue to carry out low regret work this year relating to the further development and implementation of early competition. That work should provide further clarity on the areas we reference above.

³ The party responsible for running the early competition tender. For the avoidance of doubt, the term “Procurement Body” reflects the name given by the ESO in the ECP. It should not be read as an implication that a decision has been made on whether and how procurement legislation will apply to this role and/or the proposed regime.

⁴ <https://www.ofgem.gov.uk/publications/update-electricity-system-operators-early-competition-plan-0>

Legislative change is required to underpin a 'full' version of the early competition model proposed in the ESO's ECP. The government has set out its intention to introduce the required legislation⁵, and the Department for Business, Energy and Industrial Strategy (**BEIS**) is working closely with us and industry to develop this policy to ready themselves to legislate when Parliamentary time allows. As part of this, BEIS are consulting on competition in onshore electricity networks⁶. We will continue to work closely with BEIS as this work progresses.

⁵ In the Energy White Paper, BEIS committed to legislate to enable competitive tenders in onshore electricity networks; <https://www.gov.uk/government/publications/energy-white-paper-powering-our-net-zero-future>

⁶ <https://www.gov.uk/government/consultations/competition-in-onshore-electricity-networks>

1. Introduction

What are we consulting on?

1.1. This document summarises our views on early competition, including the ESO's Early Competition Plan's (ECP) findings. Published alongside it is an Impact Assessment that considers the case for further developing early competition so it can be ready to be used in the design and delivery of solutions to meet needs on the electricity transmission network.

Section 2: Early Competition context and overview

1.2. Chapter 2 provides background on what Early Competition means, and how it has developed in the electricity transmission sector over the last few years.

Section 3: ESO's Early Competition Plan

1.3. Chapter 3 explains the ESO's ECP, and provides a summary of what this consultation covers.

Section 4: Identifying which needs are suitable for early competition

1.4. Chapter 4 explains how the ESO's ECP proposes projects would be identified as suitable for early competition and how the criteria for early competition should be calibrated, and sets out our consideration of these proposals for consultation.

Section 5: Roles and Responsibilities within Early Competition

1.5. Chapter 5 provides a summary of the roles and responsibilities which the ESO proposed would be required to facilitate early model competition and our views on these proposals.

Section 6: Tender process and commercial model

1.6. Chapter 6 summarises the tender process and commercial model proposed by the ESO in its ECP and our initial views on these proposals.

Context and related publications

Proposals for a Future System Operator role (July 2021)

<https://www.gov.uk/government/consultations/proposals-for-a-future-system-operator-role>

Ofgem Update on Electricity System Operators Early Competition Plan (May 2021)

<https://www.ofgem.gov.uk/publications/update-electricity-system-operators-early-competition-plan-0>

ESO Early Competition Plan – Onshore Transmission (April 2021)

<https://www.nationalgrideso.com/future-energy/projects/early-competition-plan/project-documents-early-competition>

Ofgem Update on the Electricity System Operators Early Competition Plan (May 2020)

<https://www.ofgem.gov.uk/publications/update-electricity-system-operators-early-competition-plan>

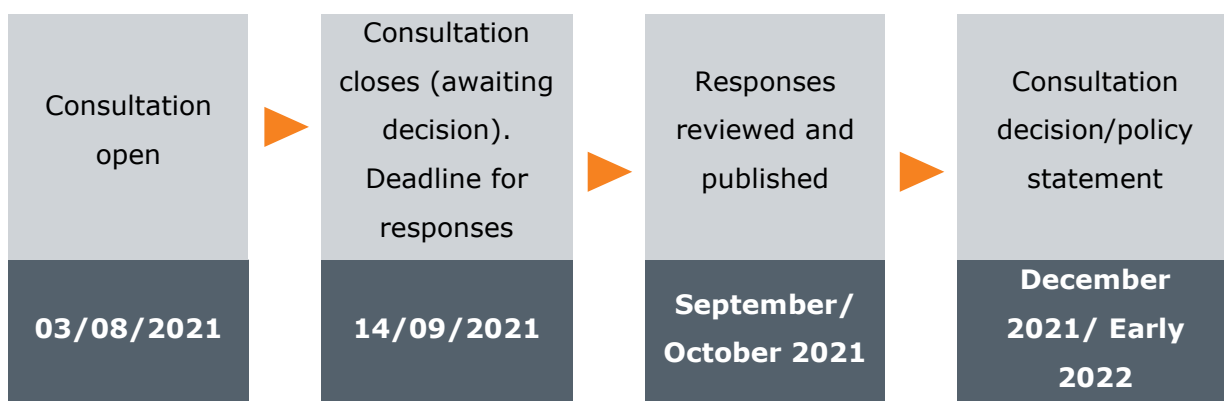
Electricity System Operator’s Early Competition Plan Letter (September 2019)

<https://www.ofgem.gov.uk/publications/electricity-system-operators-early-competition-plan-letter>

RIIO-2 Sector Specific Methodology Decision (May 2019)

<https://www.ofgem.gov.uk/publications/riio-2-sector-specific-methodology-decision>

Consultation stages



How to respond

1.7. We want to hear from anyone interested in this consultation. Please send your response to the person or team named on this document's front page.

1.8. We've asked for your feedback in each of the questions throughout. Please respond to each one as fully as you can.

1.9. We will publish non-confidential responses on our website at www.ofgem.gov.uk/consultations.

Your response, data and confidentiality

1.10. You can ask us to keep your response, or parts of your response, confidential. We'll respect this, subject to obligations to disclose information, for example, under the Freedom of Information Act 2000, the Environmental Information Regulations 2004, statutory directions, court orders, government regulations or where you give us explicit permission to disclose. If you do want us to keep your response confidential, please clearly mark this on your response and explain why.

1.11. If you wish us to keep part of your response confidential, please clearly mark those parts of your response that you *do* wish to be kept confidential and those that you *do not* wish to be kept confidential. Please put the confidential material in a separate appendix to your response. If necessary, we'll get in touch with you to discuss which parts of the information in your response should be kept confidential, and which can be published. We might ask for reasons why.

1.12. If the information you give in your response contains personal data under the General Data Protection Regulation (Regulation (EU) 2016/679) as retained in domestic law following the UK's withdrawal from the European Union (**UK GDPR**), the Gas and Electricity Markets Authority will be the data controller for the purposes of UK GDPR. Ofgem uses the information in responses in performing its statutory functions and in accordance with section 105 of the Utilities Act 2000. Please refer to our Privacy Notice on consultations, see Appendix 4.

1.13. If you wish to respond confidentially, we'll keep your response itself confidential, but we will publish the number (but not the names) of confidential responses we receive. We won't link responses to respondents if we publish a summary of responses, and we will evaluate each response on its own merits without undermining your right to confidentiality.

General feedback

1.14. We believe that consultation is at the heart of good policy development. We welcome any comments about how we've run this consultation. We'd also like to get your answers to these questions:

1. Do you have any comments about the overall process of this consultation?
2. Do you have any comments about its tone and content?
3. Was it easy to read and understand? Or could it have been better written?
4. Were its conclusions balanced?
5. Did it make reasoned recommendations for improvement?
6. Any further comments?

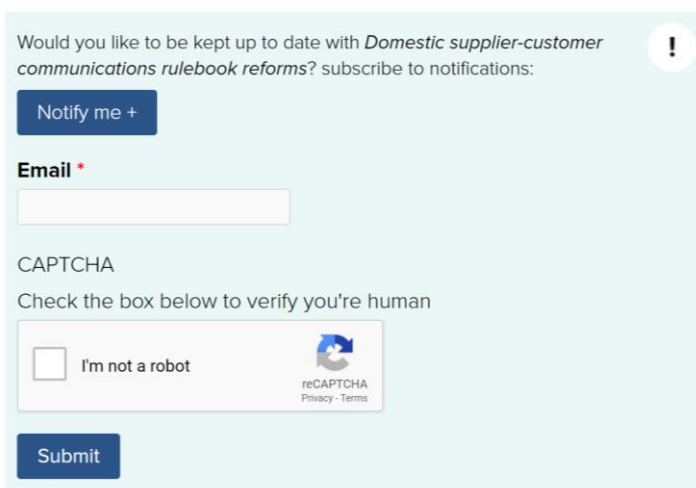
Please send any general feedback comments to stakeholders@ofgem.gov.uk

How to track the progress of the consultation

You can track the progress of a consultation from upcoming to decision status using the 'notify me' function on a consultation page when published on our website.

[Ofgem.gov.uk/consultations.](https://www.ofgem.gov.uk/consultations)

Notifications




Would you like to be kept up to date with *Domestic supplier-customer communications rulebook reforms*? subscribe to notifications: !

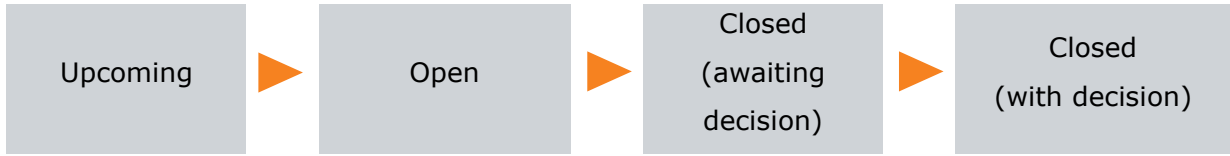
Email *

CAPTCHA

Check the box below to verify you're human

I'm not a robot  reCAPTCHA
Privacy - Terms

Once subscribed to the notifications for a particular consultation, you will receive an email to notify you when it has changed status. Our consultation stages are:



2. Early Competition context and overview

Section summary

This Chapter provides background on what Early Competition means, and how it has developed in the electricity transmission sector over the last few years.

Background

This consultation

2.1. Competition in the design and delivery of energy networks is a central aspect of our RIIO-2 price controls. Competition has a key role to play in driving innovative solutions and efficient delivery that can help us meet our decarbonisation targets at the lowest cost to consumers.

2.2. In our May 2019 RIIO-2 Sector Specific Methodology Decision (**SSMD**)⁷, we requested that the Electricity System Operator (**ESO**) work on a plan for early competition alongside its RIIO-2 Business Plan. Our expectation was that the arrangements in this plan would cover the electricity transmission sector initially, but we also asked the ESO to provide views on how this could be applied to electricity distribution in the next electricity distribution price control, RIIO-ED2. In our December 2020 RIIO-2 Final Determinations⁸ we explained that we would consider the ECP once it is finalised, and consult on our views.

2.3. In April 2021 the ESO published its final Early Competition Plan (**ECP**)⁹. This consultation summarises our views on early competition, including the ECP's findings, alongside an Impact Assessment that considers the case for further developing early competition so it can be ready to be used in the design and delivery of solutions to needs on the electricity transmission network.

⁷ <https://www.ofgem.gov.uk/publications/riio-2-sector-specific-methodology-decision>

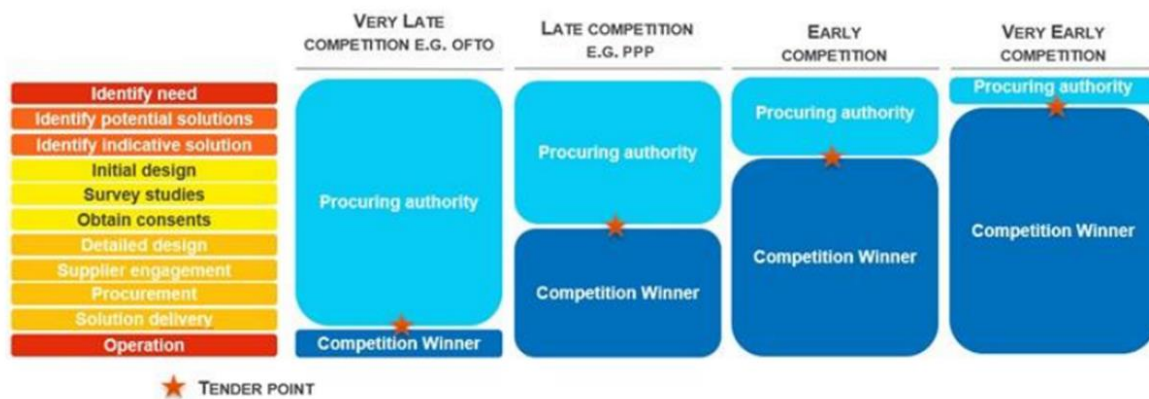
⁸ https://www.ofgem.gov.uk/sites/default/files/docs/2021/02/final_determinations_-_core_document_revised.pdf

⁹ Further information is available here, ESO final Early Competition Plan, April 2021; <https://www.nationalgrideso.com/document/191251/download>

What is early competition?

2.4. Early competition refers to a competitive tender that takes place ahead of detailed design work for the preferred solution. In the context of this consultation, in an early competition bidders would compete to design, build and own a solution that addresses a specific requirement on the electricity transmission network. This differs from 'late competition', where bidders compete to deliver and own a specific project that has already been designed in sufficient detail necessary to secure major planning consents. As such, early competition should allow for a wider range of solutions and bidders to compete (for example, proposed solutions do not need to be limited to electricity transmission assets).

Figure 1 – Tender point under various models of competition



How has early competition developed in the electricity transmission sector?

2.5. As Great Britain continues its transition to a net-zero carbon economy by 2050 it is expected that investment in the electricity transmission network will need to intensify to accommodate shifts in sources of supply and demand. The requirement for this investment has led to a focus over the last few years on expanding the role of third parties in the design and delivery of the electricity transmission network. The intent of widening the role of third parties in networks is to maximise value for money for consumers by ensuring that a full range of potential solutions can be considered for the network needs, beyond those that are designed and delivered by the existing transmission owners (**TOs**).

2.6. The government has set out its intention to introduce new legislation¹⁰ to enable competitive tendering for building, owning and operating onshore electricity network assets,

¹⁰ Page 77, Energy White Paper (publishing.service.gov.uk) (Powering our Net Zero Future, December 2020)

when Parliamentary time allows. Today Government has published a consultation on competition in onshore electricity networks which provides an update on this policy, including early competition, as well as seeking stakeholder views on implementation of the legislative framework for competition¹¹.

2.7. In parallel the ESO has developed a number of stand-alone “Pathfinder” processes over the last couple of years to allow additional competition in the development of solutions to a narrow range of needs on the electricity transmission network. The pathfinders allow third-party providers to compete to deliver specified network services, with the winning party entering into a contract with the ESO to provide those services. As such, the pathfinders are a form of early competition which the ESO intends to continue to develop and improve alongside the work it has committed to on the continued development of its ECP proposals.

Electricity transmission network planning and its interaction with early competition

2.8. The annual Network Options Assessment (**NOA**) process is the main mechanism by which most major investments in the onshore GB electricity transmission network are currently identified and planned. Under the NOA process, the ESO identifies existing network capabilities, and uses the Future Energy Scenarios (**FES**) forecasts to identify where and how the current network capabilities may not be sufficient in the future. This information is provided to the TOs, who use this information to develop potential investments that are able to improve the electricity transmission network capability to address these future requirements. These TO proposals are considered by the ESO alongside its own assessment of the likely benefits of potential alternative options¹², with solutions assessed through a cost benefit analysis (**CBA**). This CBA determines the optimum mix of investments across the FES scenarios. This provides an indication of which TO investment projects and commercial solutions identified by the ESO should progress.

2.9. In line with its evolving obligations, the ESO has sought to expand the range of solutions and parties involved in the NOA process in order to ensure that the network can be upgraded as efficiently as possible for consumers. In the 2021 NOA report, eight potential commercial

¹¹ <https://www.gov.uk/government/consultations/competition-in-onshore-electricity-networks>

¹² Table 2.2 on page 17 of the NOA methodology sets out the range of options that can be considered by the ESO: <https://www.nationalgrideso.com/document/174231/download>

solutions were identified and considered by the ESO, with four recommended to proceed following the CBA process.

2.10. In addition the ESO has introduced what is known as the “interested persons process”. This is designed to allow non-TO developers’ further involvement in network design by allowing them to put forward design ideas that can then be considered by the ESO as part of the annual NOA process.

2.11. There are certain types of investment, such as asset replacement and connection wider works, which have previously not been captured within the ESO’s NOA analysis. The ESO is also seeking to incorporate these types of investments into the NOA assessment process during the RIIO-2 period.

2.12. The network planning processes in general, including the NOA process, are critical in ensuring that necessary investment is delivered to allow Great Britain to reach its Net Zero targets. For this reason we are carrying out a strategic review of onshore electricity transmission network planning. This is to ensure that it can efficiently support the delivery of Net Zero at the lowest cost to consumers. The review will consider analysis and decision making underpinning solutions for how electricity transmission system needs are addressed, as well as the role and responsibilities of all parties in early development of these solutions.

2.13. It is critical that any development of an early competition model fully considers the appropriate interaction with network planning processes, particularly those that operate within the annual NOA process. It is also important that any existing barriers to early competition within the existing network planning arrangements are identified and potential mitigations considered through our network planning review.

The future role of the ESO and its interaction with early competition

2.14. The role of the ESO within network planning and operation will be pivotal to allowing us to meet our Net Zero targets in the most effective way possible and at the lowest possible cost to consumers. With this in mind, we and BEIS are consulting on proposals for an expert,

impartial Future System Operator (**FSO**) with responsibilities across both the electricity and gas systems, including all the current roles and functions of the ESO¹³.

2.15. It is critical that any development of an early competition model is compatible with the ESO's existing responsibilities, whilst also being able to evolve to reflect future changes to the electricity system operation responsibilities as part of the FSO project. It is also important that in the development of early competition, any changes in the roles and responsibilities of the ESO are identified and considered as the roles and responsibilities of the FSO are developed in detail.

2.16. We have taken into account the FSO project in reaching the positions set out in this consultation. We consider that all the arrangements summarised and positions set out are compatible with the findings from the FSO project to date, but we will keep this under review as we develop the early competition arrangements further.

Interaction with late competition

2.17. We remain committed to the development of late competition as part of the RIIO price control arrangements. Whilst we consider that early competition has the potential to deliver savings through a wider scope for innovation in design and delivery of solutions to network issues, we also recognise there will remain a significant number of projects that are not suitable for early competition (for example where the high level solution design is already confirmed), but where savings can be delivered through late competition.

2.18. The late competition arrangements are outside of the scope of this consultation and will be developed through future consultation once we have further clarity on the timings for enabling legislation. At that time, we will consider whether it would be appropriate to make adjustments to the late competition arrangements in place for RIIO-2, and those previously consulted on back in 2016¹⁴ to reflect our updated thinking from the work undertaken on early competition. This could include, for example, the allocation of roles and responsibilities, and/or

¹³ <https://www.gov.uk/government/consultations/proposals-for-a-future-system-operator-role>

¹⁴ <https://www.ofgem.gov.uk/publications/extending-competition-electricity-transmission-decision-criteria-pre-tender-and-conflict-mitigation-arrangements>

specific aspects of the arrangements for tender process or commercial model for successful bidders.

Interaction with Offshore Transmission Network Review (OTNR)

2.19. In light of the Government's offshore wind target of 40GW by 2030, and the expectation of more offshore wind beyond that to deliver net-zero by 2050, constructing individual point-to-point connections for each offshore wind farm may not provide the most efficient approach and could become a barrier to delivery. In July 2020, the Government OTNR, a BEIS-led cross-industry project in which we provide leadership on specific areas.

2.20. Earlier this month we published our consultation on changes intended to bring about greater coordination in the development of offshore energy networks¹⁵. The Pathway to 2030 workstream of the OTNR seeks to develop a more coordinated model for delivery of offshore transmission infrastructure. It also explores potential delivery models for offshore infrastructure, with a number involving a level of competition, including early and very early competition. That consultation is clear that delivery models for onshore infrastructure are not within scope and that different models could apply onshore and offshore.

2.21. However, as the early competition and OTNR work evolves, we will continue to look at how best to ensure that the respective regimes can operate in a co-ordinated fashion, and adopt common approaches where appropriate to do so.

¹⁵ https://www.ofgem.gov.uk/sites/default/files/2021-07/OTNR%20Ofgem%20Consultation_Jul%202021_Final%20%281%29.pdf

3. ESO's Early Competition Plan

Section summary

This Chapter explains the ESO's Early Competition Plan, and what this consultation covers.

Questions

Question 1: Do you agree that the continued development of the arrangements to allow early competition in electricity transmission represents good value for money for consumers?

3.1. The ESO's ECP was developed through multiple stages of consultation over the last 12-14 months, with workshops carried out throughout 2020 and early 2021, with input from a range of stakeholders including existing TOs, investors, third-party solution providers and other interested stakeholders.

3.2. The ECP sets out the ESO's view on how an early competition tender process could work, and how it could be incorporated into the electricity transmission network planning process. The ESO's proposals for early competition are intended to build on the benefits unlocked by the pathfinder processes and, once the necessary legislation is in place, allow for a full range of network and non-network solutions to participate in such competitions.

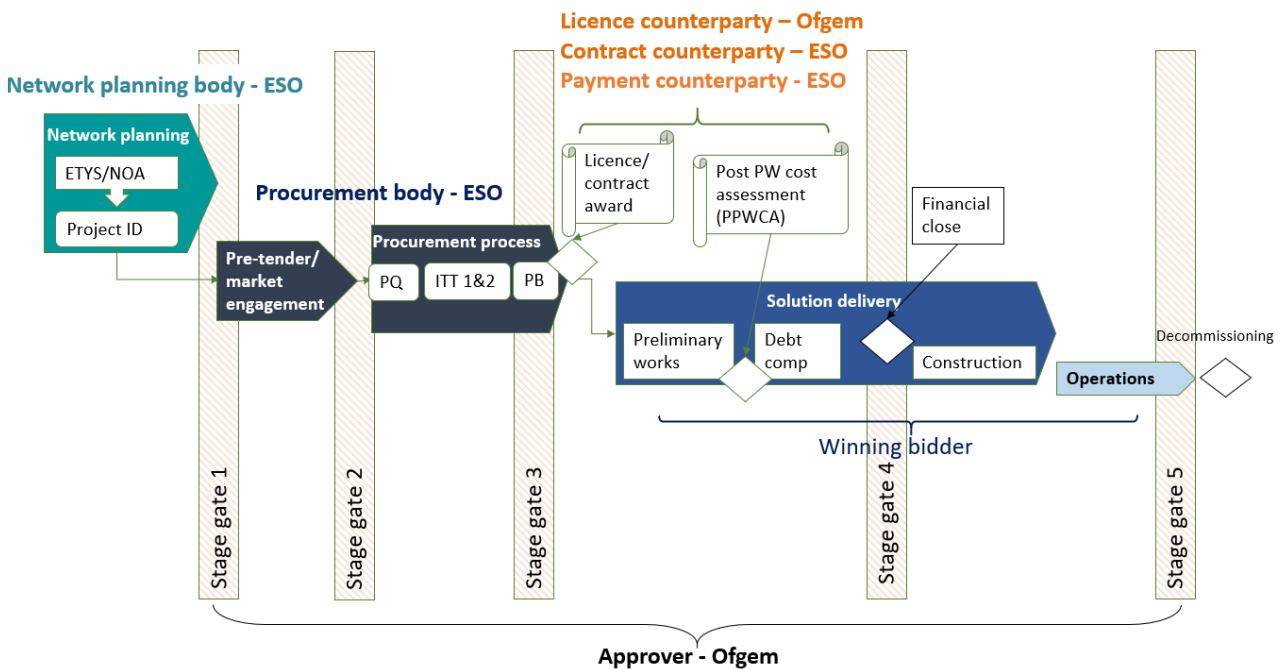
3.3. The ECP includes the ESO's view on the following key considerations for an early competition model:

- The process followed to determine whether specific projects should progress to an early competition tender process
- The criteria that should be used to identify projects from this process that are suitable for early competition
- The high-level tender policy and arrangements and commercial model applied to successful bidders

- Identification of the key roles within early competition and the parties best placed to undertake those roles
- Additional thinking around potential changes to industry codes needed to implement early competition, and draft heads of terms that could be used for a licence or contract awarded to the successful bidder as a result of the tender process.

3.4. The diagram below represents the high-level stages of the proposed early competition model within the ESO’s ECP, with the parties proposed to carry out each role identified.

Figure 2 – High-level overview of ESO’s proposed early competition model and allocated roles



Acronym in diagram	Explanation
ETYS	Electricity Ten Year Statement
NOA	Network Options Assessment
PQ	Pre-Qualification
ITT	Invitation To Tender
PB	Preferred Bidder
PPWCA	Post Preliminary Works Cost Assessment

Summary of our views

3.5. At this stage in the development of the early competition model, we focus in this consultation on identification of the parties best placed to carry out the key functions within early competition, and the process through which network needs are identified as suitable for early competition. This is because these aspects are central to enable the timely development of the rest of the early competition framework.

3.6. As set out in the ESO's ECP, there remains significant work to be done to finalise the specific tender arrangements and detailed commercial and regulatory model. Certain aspects of this work can only be fully completed once the Procurement Body¹⁶ responsibilities have been allocated and once we have made a decision, following this consultation, on whether and how early competition should be further developed and implemented. For this reason we provide only our initial views on the tender process and commercial model (in Chapter 5), but will consult on our views on these aspects in more detail once the early competition roles have been finalised and allocated and the relevant work has been sufficiently progressed.

3.7. Overall we consider that the ESO has done a good job in engaging with a range of stakeholders in order to develop a coherent set of proposals for early competition.

3.8. In terms of the early competition model proposed by the ESO in the ECP, we consider that the tender process and the commercial model (what is on offer to successful bidders) are reasonable and we do not have any immediate concerns at this stage in their development. We agree with the distribution of roles and responsibilities proposed by the ESO in the ECP. Subject to this being in alignment with the FSO project and underpinning legislation, we agree that the ESO, as the Procurement Body, is likely to be best placed to run early competitions. We set out our reasoning for this in paragraph 5.14.

3.9. The process proposed by the ESO for identifying network needs that are suitable for early competition appears sensible and logical. We consider that it fits well within existing network design arrangements and processes, but have identified certain aspects that we think require additional consideration before we reach a final decision. Specifically, we would like the ESO to expand on its thinking around how the benefits of competition and innovation can be incorporated into the design process at an earlier stage. This could be through either additional third-party involvement in the development of indicative solutions, as well as considering, as the early competition model evolves, whether there will be certain circumstances where the competition could start at an earlier stage. We also think it is important for the ESO to set out additional practical detail for stakeholders on how the proposed early competition model will differ and/or interact with the existing pathfinder processes.

¹⁶ The party responsible for running the early competition tender. For the avoidance of doubt, the term "Procurement Body" reflects the name given by the ESO in the ECP. It should not be read as an implication that a decision has been made on whether and how procurement legislation will apply to this role and/or the proposed regime.

3.10. As set out in the accompanying Impact Assessment, we consider that the continued development of the arrangements to allow early competition in onshore electricity transmission represents good value for money for consumers as it is relatively low regret, whilst the potential savings over the longer-term are likely to be significant. Additionally, we consider that having a coherent and well developed set of competition arrangements as an option to deliver the infrastructure necessary to meet Net Zero targets is an important part of the toolkit for Ofgem. We have identified network competition as an area the FSO would be well suited to taking on more responsibilities, and this work could act as a step to realise some of the benefits identified earlier. We also consider that having a workable early competition model is important in the context of future network planning, as this could provide a mechanism for introducing major design innovation into the sector as well as a route to market for technologies that could deliver considerable benefits for GB consumers.

4. Identifying which projects are suitable for Early Competition

Section summary

This Chapter explains how the ESO's ECP proposes network needs would be identified as suitable for early competition and how the criteria for early competition should be calibrated, and sets out our consideration of these proposals for consultation.

Questions

Question 1: Do stakeholders have any views on how a very early competition could be accommodated within the network planning process without having a detrimental impact on the planning of the rest of the network, or whether there are any specific network situations where a very early competition could be run for a solution without it having a detrimental impact on the planning of the wider network?

Question 2: Do you agree with our assessment of the ESO's proposed process for defining the technical scope of a tender under an early competition?

Question 3: Do you agree with our assessment of the ESO's proposed criteria for early competition? Specifically, do you have any views on whether:

- there is a need for a 'high value' criterion?
- 'new' and 'separable' are necessary or appropriate as specific criteria for identifying projects for early competition?

Introduction

4.1. Within this Chapter, we set out the process that the ESO's ECP suggests should be followed for selecting which proposed investments are required to address needs on the electricity transmission network. We also consider whether there is a case for very early competition, and set out the criteria and process that the ESO has proposed for determining which proposed investments on the network are suitable for early competition. We also give

our views on the ESO's proposals. We welcome stakeholder feedback on the specific questions asked, as well as any wider feedback.

At which point should the competition be run?

4.2. As referenced in paragraph 2.4, early competition refers to a competitive tender that takes place ahead of detailed design work for a preferred solution. An initial consideration for the ECP was at which point ahead of the detailed design work the tender should take place.

4.3. As shown in Figure 1 in Chapter 2, there are several points ahead of the detailed design work at which the tender could potentially take place. If the tender takes place after the need has been identified but before potential solutions are identified, this is referred to as "very early competition". If the tender takes place slightly later, after an indicative solution has been identified, this is referred to as "early competition".

Comparing early competition to very early competition

4.4. We consider that there are both advantages and disadvantages to very early competition when compared to early competition. In principle, a standalone tender process that takes place before an indicative solution has been identified, via a very early competition, can in theory allow for a wider range of solutions to compete, with the market determining the optimum solution. All else being equal, this approach could be considered beneficial relative to a later tender with a more restricted scope.

4.5. However, the later tender under an early competition could be beneficial in other ways. Specifically, a more defined scoping of the network need, based on an indicative solution should reduce uncertainty from the design of the rest of the network planning process. It should also significantly reduce the complexity of the bid assessment process during the competitive tender.

4.6. The NOA process uses cost benefit analysis to consider the optimum combination of investments across the network. This is because the initial identification of a solution to a specific network need can have a pronounced impact on the design of other projects that are located nearby or that share the same driver of need. For example, a network upgrade may have the option of connecting into two different substations in different parts of GB. This choice between two locations could have a profound effect on the subsequent work needed at either location. The selection of one location could be the lowest cost option for the project, but could

lead to additional costs elsewhere on the network, making the alternative the most efficient option from the perspective of the network as a whole.

4.7. If a very early competition model is implemented, there is a risk that the range of potential solutions will make it very difficult to plan subsequent or related network requirements in a particular location. This is because the outcome of the very early competition could have a significant impact on the optimum design of these related projects (which themselves may be suitable for consideration for competition). Additionally, under a very early competition, the relative benefits of different solutions put forward in a very early competition could change during the procurement process as the scope of other, related projects, is refined.

ESO conclusion on early competition vs. very early competition

4.8. The ESO's ECP concludes that an early competition is preferable to a very early competition. This was due to the challenges that it concluded a very early competition would cause for the planning of the wider network, and the resulting complexity of assessing bids. Without sensible limits on what solutions could win the competition and their impact on the design of the wider network it concluded it would be very difficult to determine an appropriate winner. The ESO view was also informed by the feedback of bidders that emphasised the importance of having sufficient clarity through the tender specification to allow them to effectively tailor their bids. The ESO's view is that by defining the scope of a competition based on an indicative design, the progression of other system needs and projects will remain insulated from the impact of the competition. This should ensure that the need and indicative design for these related projects, which may not need to be delivered until slightly later, can be confirmed before the result of the competition.

Our view on early competition vs. very early competition

4.9. We agree that the trade-off between additional certainty for bidders and for network planning versus the potential for a wider range of approaches to bid (albeit that this may result in a more complex tender evaluation process) is a key consideration when choosing between early and very early competition.

4.10. It is difficult to see how a very early competition model could be implemented without introducing a significant level of uncertainty and complexity to wider network planning and the tender evaluation process. We therefore consider that early competition would be likely to deliver greater benefit to consumers than very early competition. On this basis, we consider

the ESO's proposed use of early competition is a sensible basis on which to continue the development of the early competition model at this point in time.

4.11. Notwithstanding the above, we recognise that there is scope for the proposed arrangements to evolve. There may also be situations, such as where a particular network need won't interact materially with other potential projects, where it may be possible to run a very early competition without having an unacceptable impact on the planning of the rest of the network. Through this consultation process we will consider the views put forward by stakeholders on whether and how a very early competition model could be implemented without having a detrimental impact on the planning of the wider network. This will inform our view on whether we agree with the ESO's view that early competition would always be preferable to very early competition.

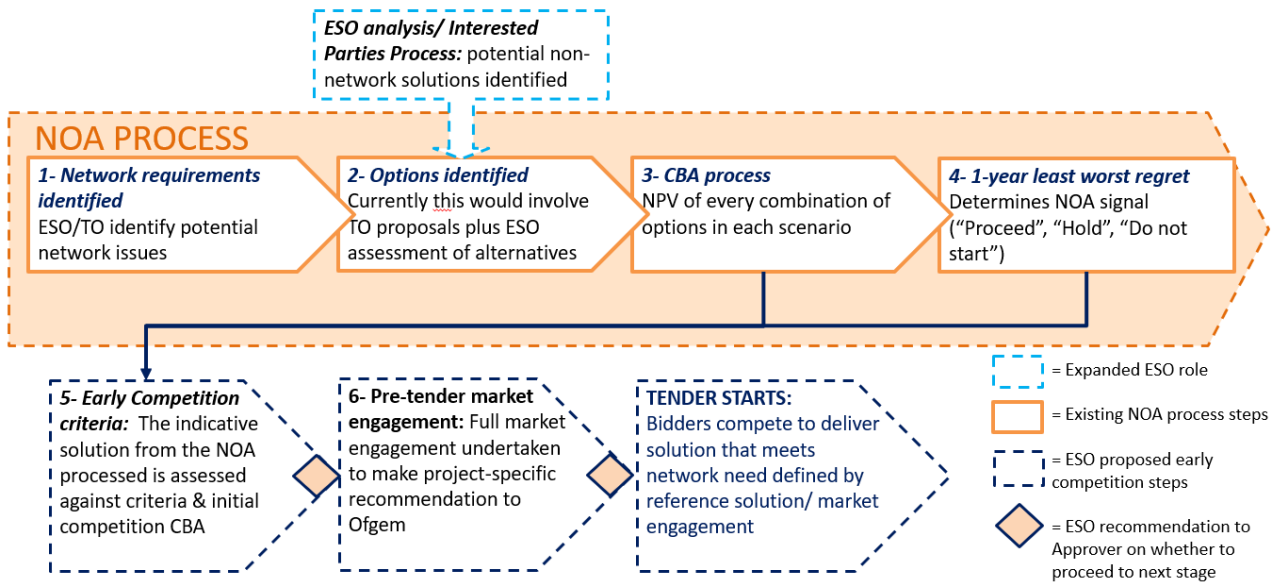
What process should be followed to define the technical scope of a tender under an early competition?

4.12. As referenced in the paragraph 4.2, under an early competition, the tender process would start after an indicative solution has been identified.

ESO view on process followed to define the technical scope of a tender

4.13. Within the ESO's ECP, it proposed that the indicative solution is identified in line with the existing network planning process, primarily through the annual NOA process. The scope of the indicative solution will be ultimately used to set the scope of the early competition tender. As referenced in paragraph 2.11, the ESO intends to widen the range of projects that are considered through the NOA. If there are projects that are suitable for early competition, but at the time are unable to be assessed through the NOA process, the ESO expects that they will be subject to an equivalent assessment process. This will be subject to further development by the ESO.

Figure 3 – ESO proposed process followed to define the technical scope of the tender



4.14. As set out in paragraph 2.8 under the NOA process, the ESO identifies existing network capabilities, and uses the FES forecasts to identify where and how the current network capabilities may not be sufficient in the future. This information is provided to the TOs, who use this information to develop potential investments that are able to improve the electricity transmission network capability to address these future requirements. These TO proposals are considered by the ESO alongside its own analysis of potential commercial solutions. This will include any evidence derived from the Interested Persons process¹⁷, which allows for third parties to propose third-party, principally non-network, solutions. It is possible that the Interested Persons process may in future identify solutions that outperform other options within the analysis undertaken to determine the indicative solution to a network need and so play an integral role in setting the specification of an early competition tender.

4.15. The ESO runs a cost benefit analysis for every combination of the TO and relevant commercial solutions in each of the four FES scenarios based on their assigned Earliest In

¹⁷ The Interested Persons' Process is a process designed to increase the diversity of options considered within the NOA process through industry and academic participation. Under the process third-parties can suggest new and innovative options that would not otherwise be captured in the NOA process. If the third-party must give demonstrable evidence of benefit to meet system needs, there is scope for the ESO and TOs to provide additional support and analysis.

Service Date (**EISD**)¹⁸. The combination of projects in each FES scenario that delivers the greatest consumer benefit in terms of reduced constraints vs costs of delivery is considered the optimum investment path for that scenario. An equivalent CBA is run with each project delayed by one year from its EISD. This allows for a distinction between projects that are needed, and need to start immediately in order to meet their EISD, and those that are needed but do not need to start immediately.

4.16. In the ECP, the ESO proposes that all projects that are identified as being part of the optimal mix of projects in more than one scenario in the NOA analysis, including those that do not need to start immediately, should then be assessed against the ESO's proposed criteria for early competition (as set out in paragraph 4.24). The ESO's rationale for this criteria and our consideration of the proposed criteria is covered in paragraphs 4.25 - 4.38.

4.17. Where a project meets the proposed criteria for early competition, the scope of the indicative solution is used to define the scope of the early competition tender process. The competition would not be run for the delivery of the specific indicative solution but, rather, that indicative solution would be used to set high-level technical and locational limits within the tender that bids would need to adhere to.

4.18. Where any indicative solution from the NOA process meets the early competition criteria, the ESO proposes that it would then progress to be subject to market engagement during the pre-tender process. During this stage, the Procurement Body would engage with the market of potential bidders. This would be to validate the assumptions upon which the indicative solution has been designed, as well as the likelihood of attracting a competitive range of bids and bidders interested in delivering the project. Following this process, the Procurement Body would make a recommendation to Ofgem as the Approver¹⁹, on whether the tender should start.

Our view on process followed to define the technical scope of a tender

4.19. We consider that the ESO has developed a sensible approach to determining which projects progress to an early competition. Its proposed approach builds on the existing NOA process which is well established as a network planning tool. The proposals have developed in

¹⁸ The EISD of a specific project is the earliest date that it can be delivered based on the expected time taken to develop, plan and build the project.

¹⁹ The ESO proposes an "Approver" role, which would be responsible for making the formal decision to progress stage gates (before, during and after an early competition tender). Under the ESO proposals, this would be Ofgem.

response to the feedback from stakeholders and sensibly prioritise the importance of ensuring that important investment in the transmission network is delivered in a timely manner.

4.20. We recognise the clear benefits of introducing an early competition model within the context of the existing NOA process which is well understood by stakeholders in the market. The process outlined would allow for a wider range of solutions to be considered for meeting network needs. The process would build on the ESO's existing role in identifying commercial solutions within the NOA process, as well as providing a route to market for any solutions identified through the recently established "Interested Persons process", whereby third parties can put forward alternative solutions to those identified by the TOs and ESO through the NOA process.

4.21. Whilst we consider that the ESO has developed a logical approach to identifying projects that are suitable for early competition, we consider it important that the scope of any early competition tender allows for as wide a range of solutions as possible within the limitations of the NOA analysis. Whilst the proposals set out in the ESO's ECP are aligned with the existing industry processes around network planning, we anticipate that they should be able to evolve as appropriate in line with the evolution of other roles within the network planning process. For example, the ESO proposals assume that new connection wider works and large asset replacement projects will ultimately be incorporated within the annual NOA process. It is possible that an alternative approach is ultimately determined for these types of work outside of the NOA process. If this is the case, we anticipate that the early competition arrangements outlined would be adjusted accordingly.

What should the criteria for identifying projects for early competition be?

4.22. Within our work on late competition, we developed the criteria for competition that we and the ESO use to consider whether we expect a proposed transmission project might be suitable for late competition. These criteria are defined as new, separable and high value. The purpose of these criteria is to exclude projects that are unlikely to be able to deliver consumer benefits through late competition. Our analysis found that new projects²⁰, where ownership and responsibility can be separated clearly from the rest of the network, would be the most

²⁰ a complete replacement of existing assets is also included in the definition of 'New'

attractive to potential bidders, and that projects would need to be of sufficient value to offset the costs of running a competition. Our original analysis identified a range of £50m - £100m for the high-value aspect of the criteria. We used this analysis to set the high-value threshold for late competition at £100m.

4.23. Given the additional range of potential benefits available through an early competition, we wanted to consider whether the £100m threshold would be needed as a criterion for early competition. As part of the ECP, we tasked the ESO with identifying suitable criteria for distinguishing projects that would be able to deliver consumer benefits through early competition.

ESO views on what the criteria for early competition should be

4.24. The ESO recommends that the criteria for early competition, which each indicative solution from the NOA is assessed against, should be as follows:

- New
- Separable
- Certainty (indicative solution is needed in at least two FES scenarios within the NOA)
- Initial competition CBA supports that running an early competition is likely to provide an outcome that is beneficial for consumers.

Whether there should be a value threshold

4.25. In line with our initial thinking that a £100m threshold might be too high for the early competition model, the ESO proposes that no value threshold is needed for their model of early competition. The ESO found that evidence from international examples of early competitions, as well as its own Pathfinder processes indicates that savings could be delivered for a range of projects, including those originally expected to be around the £20m value and below. This is because the range of solutions that would be able to compete, including potentially significantly lower cost non-network solutions, should lead to a wider range of possible savings than a late model competition, where the technical solution is already defined through the detailed network design that occurs prior to the competition.

4.26. Rather than relying on a high value threshold, the ESO proposes that a CBA is used to identify which projects should progress to an early competition tender (the '**initial competition CBA**'). The ESO's expectation is that this initial competition CBA would be carried out on all projects that meet the rest of the criteria for early competition. This CBA would then be updated

(a **'final competition CBA'**) following the pre-tender market engagement for any project that progresses to the pre-tender stage.

4.27. The exact detail of the initial competition CBA process at this stage has not been fully developed. Our expectation from the ECP is that the purpose of running an initial competition CBA ahead of the pre-tender stage is to consider, for projects that meet the rest of the criteria for early competition, whether running an early competition could impact on the ability of the project to be delivered on time. An initial competition CBA view would give an early signal of whether there is likely to be any consumer detriment in pursuing early competition for a specific project, in terms of additional constraint costs arising from late delivery, and whether or not this is likely to offset the likely benefits of running an early competition. Where the initial competition CBA demonstrates that there is likely to be an overall consumer detriment from running an early competition on a specific project, there would be the option to progress the project outside of the early competition model (e.g. by the relevant TO under the RIIO framework) to ensure it can be delivered on time.

Whether "certainty" should form part of the criteria for early competition

4.28. During the ESO's ECP work, TOs raised concerns about whether an early competition will slow down the delivery of key investments in the transmission network. Potential bidders in an early competition have also emphasised the importance of certainty around whether the project being bid for will remain needed and is able to progress to construction.

4.29. In this context, the ESO has proposed the "Certainty" criterion within the criteria for early competition as being that a project is needed in at least two FES scenarios. The ESO considers that this should allow for the ESO to start early consideration and market engagement on particular projects ahead of a full NOA proceed signal (which should help mitigate against potential project delays), whilst still providing a level of comfort to bidders that they are not engaging on speculative projects.

Our views on what the criteria for early competition should be

Whether there should be a value threshold

4.30. We recognise the logic behind the ESO's proposal that a value threshold, like the £100m threshold for late competition, is not necessary for early competition. We agree in principle that the range of solutions available will mean that there is a wider potential for savings relative to the late competition model. However, we also recognise the feedback from all three TOs, that

not including a value threshold would lead to uncertainty over what projects will progress to early competition.

4.31. We agree with the ESO that an effective project-specific competition CBA can mitigate the need for a value threshold. The ESO will progress its thinking on how this CBA will work during the rest of this year. Until this work is sufficiently developed, we do not consider we are yet in a position to make a decision on whether there should be a value threshold (and if so, at what value that threshold should be set). We will consider and set out our view on whether the early competition criteria should have a value threshold once the ESO's work on the competition CBA and project identification in general has sufficiently developed.

Whether "certainty" should form part of the criteria for early competition

4.32. We consider that the ESO's proposed 'certainty' criterion appears to strike a sensible balance between ensuring that projects are considered for early competition as early as possible, whilst also ensuring that bidders can have sufficient comfort that the projects under consideration are not speculative investments.

4.33. We note that it was suggested by some TOs in response to the ESO's consultation on its developing ECP in December 2020, that this approach represents a lower level of project certainty than Ofgem expects under the existing Large Onshore Transmission Investment (**LOTI**) funding mechanism under the RIIO-2 arrangements. We do not consider that this is an appropriate comparison between regimes. The LOTI mechanism provides TOs with funding for the construction of transmission projects and, as such, it is appropriate that only projects that are shown to be needed²¹ are funded by consumers and therefore progress to construction. The "certainty" criterion for early competition, relates simply to whether a project should progress to the pre-tender market engagement stage. It does not confirm that construction should start and does not award any construction funding. The ESO's ECP is very clear that all projects that progress through early competition will be tested to ensure that they are needed before construction starts. This is fully in line with the equivalent process under LOTI. Ultimately, we consider that our decision on whether or not an early competition tender should start would be based on us having sufficient comfort that the project is sufficiently certain and

²¹ In the context of LOTI projects, a project is "needed" if we have approved the Final Needs Case for the project under the terms of the LOTI licence condition

remains in the interests of consumers in order to justify the costs associated with running the competition.

4.34. One area where we consider additional work will be required on this aspect of the criteria is whether reference to the FES is appropriate for the setting of an appropriate criteria to determine whether asset replacement works would be suitable for early competition. This is because one would not expect asset replacement works to be driven primarily by the FES scenarios. We will consider any developments in this thinking by the ESO and other stakeholders before reaching our final view on the appropriate criteria for early competition.

Whether "new" and "separable" should form part of the criteria for early competition

4.35. The new, separable and high value criteria for competition that we developed for late competition were derived from analysis on the sorts of projects that are likely to drive savings for consumers if late competition is applied to them. The criteria for late competition could therefore be seen as a proxy for a more detailed project-specific consideration of the costs and benefits of applying competition, as well as a way to clearly identify a pipeline of the types of projects likely to be considered appropriate for late competition.

4.36. We recognise that the criteria proposed by the ESO would provide a means of clearly identifying the types of projects likely to progress to early competition. As set out in paragraph 4.32, we also agree with the ESO that there are benefits to considering 'certainty' that justify specifying it as a specific criterion. However, given that the ESO proposes an initial competition CBA, we are not convinced that the 'new' and 'separable' criteria are as relevant or significant for early competition as for late competition. In early competition, the winning solution proposed by the successful bidder may be considerably different from the indicative solution being considered for early competition. It is therefore less clear why whether an indicative solution is new and separable or not should prevent a project from being considered for early competition. If there are additional costs associated with an indicative solution not being 'new' or 'separable' from the existing network, then it may be more appropriate to consider those alongside other costs and benefits as part of the initial competition CBA, rather than automatically ruling out indicative solutions that are not new and separable.

4.37. As such, we welcome views from stakeholders on whether the following approach would be more appropriate in terms of identifying appropriate projects for early competition:

- Indicative solutions would be assessed against the 'certainty' criterion (and also potentially assessed against a high value criterion as well, subject to our further considerations set out in paragraph 4.28).
- An initial competition CBA would be run on any indicative solutions that met the 'certainty' criterion. This initial competition CBA would consider the full range of costs and benefits associated with early competition for the project in question, including any costs and benefits to consumers associated with whether that project is 'new' and 'separable'. As proposed by the ESO in the ECP, the initial competition CBA would also consider the cost impact on consumers of any delays resulting from the competition.
- Pre-tender market engagement and a final competition CBA would then be carried out in the same way as proposed by the ESO in the ECP.

4.38. We consider that the above approach could strike an appropriate balance between not ruling out some projects unnecessarily, while still providing some clarity on the types of projects likely to be considered appropriate for late competition, as well as ensuring that early competition is only applied where there are likely to be benefits to consumers. Further to stakeholder views in response to this consultation, and as the ESO further develops the detail of the initial competition CBA, we will consider further whether "new" and "separable" are necessary or appropriate as specific criteria for identifying projects for early competition.

5. Roles and Responsibilities within Early Competition

Section summary

This Chapter provides a summary of the roles and responsibilities which the ESO proposes would be required to facilitate early model competition and our views on these proposals.

Questions

Question 1: Do you have any material concerns about the ESO's expertise, incentives, or independence, should they be appointed to carry-out the Procurement Body role for early competitions?

Question 2: Do you agree with Ofgem's proposed roles?

Question 3: Who should undertake the network planning body role? What role should TOs play in network planning?

Question 4: What are your views on the proposed conflict mitigation arrangements for TO roles? What might be an appropriate level of challenge from the ESO on solutions put forward by TOs as part of their network planning role?

Question 5: Do you agree with our views on the TO counterfactual approach?

Overview

5.1. The ESO and TOs carry out key roles within the existing industry arrangements for determining where and how investment is progressed in response to network requirements. Within the regulatory framework overseen by Ofgem, the TO is responsible for developing and progressing projects that address the current and future needs of the network within its licence area. The ESO plays a significant role in coordinating planning of the network and is responsible for real time operation of the electricity system.

5.2. It has always been our expectation that any early competition model developed would likely see changes to existing roles and the potential creation of new roles. For this reason, our September 2019²² publication requested that the ESO propose roles and responsibilities for parties to undertake at each stage of an early competition, taking into consideration the most appropriate body to fulfil these roles.

5.3. As part of our request, we additionally asked the ESO to scope its own possible role in early competition, including the practical implications of its role and responsibilities, estimated costs, expertise and risk implications.

ESO proposals on roles and responsibilities required to facilitate early model competition

5.4. The ESO has set out six key roles and responsibilities which it considers are necessary to enable early competition. As part of the development of the ECP it has consulted and engaged on these roles with relevant stakeholders such as incumbent TOs, other potential early competition bidders, and technology providers.

5.5. We have set out the roles, responsibilities and parties the ESO proposes are required to facilitate early model competition, in the table as follows:

Role	Responsibilities	Proposed Party
Network Planning Body	<ul style="list-style-type: none"> developing options for investment through the network planning process, including the indicative option considered for early competition assessing suitability for competition and some technical assessment of bids. 	ESO and TOs
Procurement Body	<ul style="list-style-type: none"> design of the procurement structure and process managing the procurement process the development of tender documentation 	ESO

22

https://www.ofgem.gov.uk/sites/default/files/docs/2019/09/electricity_system_operators_early_competition_plan_letter_0.pdf

	<ul style="list-style-type: none"> supporting the Contract Counterparty with the development of contractual documents 	
Approver	<ul style="list-style-type: none"> making formal decision to progress stage gates (before, during and after an early competition tender) 	Ofgem
Licence Counterparty	<ul style="list-style-type: none"> setting, managing and monitoring any obligations placed on a successful bidder who is issued or already holds a licence 	Ofgem
Contract Counterparty	<ul style="list-style-type: none"> setting, managing and monitoring any obligations placed on a successful bidder who is issued a contract 	ESO
Payment Counterparty	<ul style="list-style-type: none"> managing financial transactions between the successful bidder and relevant counterparty 	ESO

5.6. The roles the ESO proposes are in some cases, an expansion of existing parties' roles. As they have been created in the context of the existing network planning and system operation arrangements, the ESO recommends further consideration of roles, in light of any changes to the ESO's roles and structure (as referred to in paragraphs 2.14 - 2.16) or any changes to network planning arrangements following the current review (as referred to in paragraph 2.12).

5.7. This Chapter summarises our views on the roles and responsibilities proposed by the ESO, outlining both where we agree and where we think a different approach should be taken and why. As referenced in Chapter 4, the ESO proposes that TOs should continue to have a role to play in identifying indicative solutions that will be considered for early competition. The ESO also proposes other roles for TOs in order to facilitate the tender process (subject to the outcome of the FSO proposals and network planning review). In this Chapter we consider those roles, as well as whether TOs should be able to bid into any early competition tender process. For the purposes of this consultation, we have grouped together the roles by the party the ESO proposes to undertake them.

Proposed roles and responsibilities for the ESO in early model competition

5.8. Within its final ECP, the ESO proposes it undertakes part of the Network Planning Body role and the Procurement Body, Contract and Payment Counterparty roles. The ESO proposes that TOs could also undertake part of the Network Planning Body role.

ESO views on its own roles in early competition

5.9. The ESO proposes to strengthen its existing Network Planning Body role²³. Under the Network Planning Body role, as proposed in the ESO ECP, the ESO would be responsible for assessing the suitability of indicative solutions for competition, making recommendations to Ofgem on whether projects should be taken forward under early competition and supporting the technical assessment of bids. The ESO also recommends it would have a strengthened role in the development of solutions.

5.10. The ESO proposes it undertakes a new role as the Procurement Body. As the Procurement Body, the ESO would be responsible for the design of the early competition procurement structure and process, including the development of tender and contractual documents, in addition to launching and managing the overall procurement process. The benefits the ESO cites of it undertaking this role are: creating efficiencies with other roles in terms of bidder experience, avoiding high set-up costs and having sight of the full end-to-end tender process. The ESO believes this would lead to the best outcome for consumers. Additionally, it considers that undertaking critical roles such as the Procurement Body role and Network Planning Body role, aligns closely with its RIIO-2 ambitions of creating competition everywhere and unlocking consumer value via competition.

5.11. The ESO proposes that it plays a Contract Counterparty role, similar to its existing role with non-network solutions in the pathfinders and with balancing services providers. The ESO considers that its experience in these areas makes it the appropriate party for this role. It considers that this would build upon existing capabilities and could mean less time would be required to upskill.

²³ The Network Planning Body role is an existing role responsible for network planning and development process. An extension to the scope of this role would be to deliver early competition.

5.12. The Payment Counterparty plays an important role during the post tender stage. Under the ESO's proposals, the Payment Counterparty is responsible for managing financial transactions between the successful bidder and relevant counterparty (licence or contract). The ESO recommends it undertakes this role, as it already has experience in delivering this role through the Transmission Network Use of System (**TNUoS**) and Balancing Services Use of System (**BSUoS**) charging arrangements. The ESO is also the Payment Counterparty for Offshore Transmission Owners (**OFTOs**) appointed following a competitive tender.

Ofgem views on ESO roles in early competition

5.13. The ESO currently plays an important role within the current network planning and development process. We consider the Network Planning Body role as currently proposed, is a logical extension. We therefore agree in principle that it is best placed to undertake this role. Additionally we consider the ESO proposals are consistent with the direction of travel of both the FSO proposals and Network planning review, however will keep this under review in light of any changes to the ESO's roles and structure (as referred to in paragraph 2.14) or any changes to network planning arrangements following the current review (as referred to in paragraph 2.12).

5.14. Subject to this being in alignment with the FSO project and underpinning legislation and BEIS's consultation on appointment factors for this role, our view is that the ESO is likely to be best placed to undertake the Procurement Body role. We consider that designing and running early competitions aligns with the ESO's current roles, obligations and incentives, albeit the ESO would need to develop additional skills and capability in several areas to reflect the differences between early competitions and its other current procurement roles. The ESO has experience in procuring ancillary services, whilst also being well positioned to understand the interaction between an individual project subject to tender and the wider planning, development and operation of the network. We also consider that our oversight as the Approver (as referenced in paragraphs 5.35 and 5.49), would give confidence that the arrangements set out by the Procurement Body will be fair and robust.

5.15. We note some stakeholder feedback via the ESO early competition plan, that should the ESO carry out this role, it should be fully independent from National Grid Group. The ESO is currently a legally separate company within National Grid Group with its own licence, management board, price control and financial accounts. It must comply with a number of requirements for business separation from the rest of National Grid, including operational independence, restrictions on information sharing and physical separation. We consider the ESO is sufficiently independent from bidding parties to be an appropriate candidate for this role,

prior to any possible future changes to its ownership. We do recognise, however, that this would not fully address any prevailing perception that the ESO is insufficiently independent from bidders. This might not be fully mitigated until an independent FSO is established. However, any expertise and processes for early competition set-up by the ESO before the FSO is established and takes on the existing capabilities and functions of NGESO would mean that some benefits of early competition could be realised sooner. We would welcome views from stakeholders on whether they agree with our position and whether there are any material concerns on the ESO expertise, incentives or independence, which would affect the ESO's ability to carry out this role before any independent FSO is established.

5.16. We agree that the ESO is best placed to undertake the Contract Counterparty role. As set out earlier, the role aligns broadly with existing Contract Counterparty arrangements undertaken by the ESO. Whilst the contracting arrangements under early competition are likely to be more complex than existing standard contracting arrangements²⁴, we do not consider that any other party, sufficiently independent of potential bidders, is better placed to manage these contractual arrangements.

5.17. Finally, we are supportive of the ESO undertaking the Payment Counterparty role. This should ensure consistency with existing arrangements, and allow the ESO to manage any wider industry developments in network charging. As we would expect the proposals to be consistent with existing regulatory and code arrangements, the magnitude of changes to existing arrangements for the ESO to undertake the Payment Counterparty role should be relatively low.

ESO proposed activities at the pre-tender stage

5.18. Within the ESO's ECP, it proposed that the ESO should undertake various activities during the pre-tender stage. The ESO would undertake those activities under its Network Planning Body, Procurement Body and Contract Counterparty roles.

²⁴ This is because under the contract awarded following an early competition needs to cover a wider range of activities and a longer time period (up to 45 years)

5.19. As set out in paragraphs 4.13 to 4.18 the Network Planning Body would identify projects that are suitable for early competition, culminating in a recommendation to Ofgem of whether a project should progress to an early competition tender.

5.20. If Ofgem agrees that a project should progress to an early competition tender, then the Procurement Body would develop the appropriate tender documentation, including the bid evaluation criteria. As part of this process the Procurement Body would identify whether the nature of the project or network need requires any changes to the standard commercial model and bid evaluation framework developed previously by the Procurement Body (see chapter 6 for further detail).

5.21. At this time, the Contract Counterparty (alongside Ofgem as the Licence Counterparty), would begin to draft the Post Preliminary Works Cost Assessment (**PPWCA**)²⁵ methodology and guidance ahead of the start of any potential tender. The Contract Counterparty (as well as the Licence Counterparty) would also support development of the tender documentation referred to above.

5.22. In parallel, the Network Planning Body would also review whether there have been any changes to the network need underpinning the early competition.

5.23. Finally, the Procurement Body would then compile all information and submit to Ofgem (as the Approver) a recommendation on whether the proposed project should be progressed to the tender stage.

Ofgem view on ESO proposed activities at Pre-tender stage

5.24. We agree with the ESO's pre-tender stage activities as set out above. We consider that the Procurement Body should also play a supporting role in assisting Ofgem with drafting any secondary legislation required to set out the framework for the competitive tenders as an implementation activity.

5.25. The ESO recommends in the ECP that the pre-tender activity of assessing market appetite (as referred to in Chapter 4) is developed and explored by Ofgem once a decision has

²⁵ The purpose of the Post-Preliminary Works Cost Assessment is to adjust (where appropriate) underlying costs prior to solution delivery (i.e. when preliminary works are near complete)

been made to implement early competition. We accept that it is not necessary, and may not be appropriate to develop fully detailed market testing proposals at this time. However, we consider this aspect of the pre-tender process to be critical to ensuring that as wide a pool of bidders as possible comes forward to bid. As such, we consider that the development of robust pre-tender market engagement proposals should be prioritised by the Procurement Body, following any decision to implement early competition. We consider that Ofgem, as Approver, would have an important role in scrutinising the robustness of the pre-tender market engagement proposals, but that the arrangements should be developed by the Procurement Body.

ESO proposed activities during the tender process

5.26. The ESO sets out in the ECP that, as the Procurement Body, it would be responsible for issuing the tender commencement notice and managing each stage of the tender (including project qualification) as specified in the relevant tender documents. This would include evaluating bids and making decisions on which bidders should be invited to the next stage of the tender.

5.27. The ESO also proposes, under its Network Planning Body role, that it should be responsible for evaluating whether bids meet the network needs set out in the technical specification. The ESO considers that this activity would be an extension of its existing role in network planning, where it considers whether solutions put forward by TOs, or commercial solutions, meet network requirements. As part of this, the ESO notes it expects the TO (under its proposed network planning role) to have a role in assessing the impact of the shortlisted technical solutions at Invitation To Tender (**ITT**) stage 1²⁶ and a role in testing the impact of those solutions on their network.

5.28. At the conclusion of the ITT stage, the ESO proposes that the Procurement Body would provide a recommendation to Ofgem (as the Approver) on the preferred bidder. The recommendation would be made based on the Procurement Body's assessment of final bids against the evaluation framework. Under the ESO proposals, once the Approver approves the

²⁶ The ESO proposes that a two-stage Invitation To Tender (ITT) is the most appropriate approach to take for early competition. The first invitation to tender stage would be an initial tender stage for early competition. The aim of the ITT (stage 1) is to down-select the number of bidders which progress to the second stage. At this first stage, bidders would submit an initial solution design that demonstrates how it meets the need and that it is a suitable technology.

preferred bidder, the Procurement Body would notify all bidders of the preferred bidder and unsuccessful bidders would be provided with feedback and scoring on their bids if requested.

Ofgem view on ESO proposed activities during the tender process

5.29. Whilst we broadly agree with the activities as set out by the ESO under its proposed roles, we consider there should be a clearer distinction between the Procurement Body and Approver roles. The Procurement Body will run the procurement and therefore would and should be responsible for all elements of the tender process. As such we consider that the Procurement Body should be responsible for the preferred bidder decision. This aligns with our wider view that the Procurement Body should be making all tender process decisions, e.g. bidder shortlisting, issuing of documentation, cancellation and disqualification events, etc.

ESO proposed activities at Post Tender Stage

5.30. Under the ESO's proposals, a PPWCA will be carried-out towards the end of the preliminary works undertaken by the successful bidder. The Contract Counterparty would lead on the PPWCA (where the successful bidder has a contract) and determine any resulting Tender Revenue Stream (**TRS**)²⁷ adjustments (the ESO proposes the same role for Ofgem, as the Licence Counterparty, where the successful bidder has a licence). Following this, the ESO proposes that a debt competition would be run to set the allowed cost of debt to be factored into the TRS. The ESO proposes that the debt competition would be overseen by the Procurement Body, utilising guidance from HM Treasury in relation to preferred bidder debt competitions.

5.31. Once the successful bidder commences the preliminary works, the Payment Counterparty role begins. The Payment Counterparty would make payments at set points during the preliminary works period i.e. upon the delivery of key milestones, such as submitting planning applications, etc. At the solution delivery stage (i.e. construction period) the Payment Counterparty may also make payments, however any such payments would be considered on a case-by-case basis as part of the preparatory work for each tender process. Once the solution developed by the successful bidder has been commissioned and is operational, the Payment Counterparty would then pay the ongoing TRS (recovered via TNUoS for network solutions or

²⁷ The Early Competition Plan proposes a payment-based revenue model whereby bidders compete for regular payments over a fixed duration called a Tender Revenue Stream.

BSUoS for non-network solutions) for the revenue period. In the event the project is terminated in certain circumstances, the Payment Counterparty would also be expected to pay any termination amounts during this period.

5.32. The ESO proposals also provide initial thoughts on the approach to end of revenue options, although the ESO notes that the exact parties who are involved in this process should be further considered. The ESO's initial thoughts are that it would have two roles at this stage: i) as Contract Counterparty, to discuss the end of revenue period options (for non-network solutions); and ii) as Network Planning Body, to analyse the options. Once all options have been considered (e.g. re-tender, extension, or decommissioning) a recommendation would then be made to the approver.

Ofgem view on ESO proposed activities at Post-tender stage

5.33. We agree with the list of proposed activities that the ESO proposes would be carried out at the post-tender stage. We would expect further information and guidance on post-tender stage roles to be set out in due course as and when we make decisions on further development and implementation of early competition and on future network planning and system operation arrangements.

ESO proposed roles for Ofgem in early model competition

Overview

5.34. The early competition model as set out by the ESO recognises there is need for regulatory oversight from Ofgem, to ensure that the model delivers efficient outcomes for consumers and reduces uncertainty for bidders. In the ECP the ESO defines Ofgem's two roles as being: 1) the Approver; and 2) the Licence Counterparty.

ESO views on Ofgem's role in early competition

5.35. Under the ESO's proposals, Ofgem, as the Approver, would be responsible for ensuring that the project that progresses to early competition is, and remains, in the interest of consumers, and that the competitive process is likely to deliver benefits to GB consumers. This includes deciding whether an early competition tender process should start, approving the required tender methodology, approving tender documentation, formally deciding whether to continue the competition at each of the specified 'stage gates' of the early competition (see

Figure 2 in Chapter 3) and having oversight of the overall governance of the process (to e.g. determine whether there have been any material changes/ ensure the tender is being run in a fair and transparent way). The five stage gates identified in Figure 2 in Chapter 3 relate to key decision points along the potential project lifecycle under early competition. For example Stage Gate 2 is the point at which a decision would be made on whether the project is needed (i.e. remains in the interests of consumers) and whether the tender process should commence.

5.36. As the Licence Counterparty, Ofgem would be responsible for awarding and managing any licence awarded (or amended) to a successful bidder as a result of the early competition process.

5.37. The ESO view is that Ofgem would be best placed to undertake the Approver and Licence Counterparty roles due to our existing statutory duties to protect consumers, experience in determining whether projects are in the interests of consumers (e.g. needs case approval of large onshore transmission projects and for interconnectors under the Cap and Floor regime) and our responsibility for managing and issuing licences. Under legislation²⁸ Ofgem is currently the only party that can currently fulfil the Licence Counterparty role. As a result, stakeholder responses to the ECP strongly favoured Ofgem to undertake this role.

Our view on proposed roles for Ofgem in early model competition

5.38. We agree that we are the appropriate party to undertake both the Approver and Licence Counterparty roles.

5.39. We consider that the responsibilities that the ESO anticipates falling under the Approver and Licence Counterparty roles align with our existing remit as the sector regulator and existing legislation²⁹. Providing an alternative body with these responsibilities under early competition, could lead to a duplication of roles and create confusion for bidders and other stakeholders.

5.40. The following sections discuss the activities the ESO proposes Ofgem should undertake at each stage of the tender process (i.e. pre-tender, during the tender and post tender stages). Within these sections, we outline our views on the activities, including where we think there is

²⁸ S.6 of the Electricity Act 1989

²⁹ Legislative change is required to underpin a 'full' version of the early competition model proposed in the ESO's ECP. The government has set out its intention to introduce the required legislation and BEIS is working closely with us and industry to develop this policy to ready themselves to legislate when Parliamentary time allows.

a further or different role for Ofgem. We would welcome views from stakeholders on whether they agree with our position.

ESO's proposed activities for Ofgem at pre-tender stage

5.41. Ahead of the tender starting, the ESO proposes that Ofgem's role would focus on confirming whether it is in the interests of consumers for an early competition to start and ensuring that the suitable regulatory arrangements underpinning the competition are in place.

5.42. Under the ESO's proposals, the Network Planning Body will make a recommendation to Ofgem, as the Approver, on whether a project meets the criteria and should progress to the pre-tender stage. As the Approver, Ofgem's role is to consider the presented evidence and analysis before determining whether the Procurement Body and relevant counterparties can begin pre-tender activities.

5.43. Where we determine the pre-tender stage activities can begin, the ESO anticipates that we would support the Procurement Body and Contract Counterparty with developing the detailed tender documentation, and ultimately determine whether those documents are appropriate for delivering an economic and efficient tender process. As the Licence Counterparty, the ESO expects that our pre-tender responsibilities would focus on developing a PPWCA methodology and guidance and developing draft generic licences for successful bidders.

5.44. Once all relevant information has been obtained, including the final competition CBA, the Procurement Body would then compile all information and submit to the Approver a recommendation on whether the proposed projects should be progressed to the tender stage. Ofgem under its Approver role, would then determine whether the project is still needed, and whether it can progress to the tender stage.

Our views on proposed activities for Ofgem at pre-tender stage

5.45. We broadly agree with the ESO's proposed activities for Ofgem at the pre-tender stage.

5.46. We consider that there is a further role for Ofgem ahead of the first 'full' early competition tender commencing, in drafting the overarching tender regulations (secondary legislation).

ESO proposed activities for Ofgem during the tender process

5.47. During the tender process, the ESO proposes that the Procurement Body will submit a recommendation to the Approver as to who should be the preferred bidder. This recommendation would be made based on the Procurement Body's assessment of final bids at the ITT stage (2nd stage ITT³⁰) against the evaluation framework. As the Approver, the ESO proposes that our role would be to approve the preferred bidder.

5.48. Once the preferred bidder is appointed and has completed all necessary activities to become the successful bidder, our role would be to:

- determine whether the project remains needed and continues to be in the interests of consumers (Approver role); and,
- in the event the successful bidder is to be granted a licence (or have its existing licence amended) to determine whether the successful bidder can comply with the obligations as set out in the licence; if so, consult on a draft licence or licence modifications for the successful bidder; and then ultimately determine whether it should be awarded a licence (or have its licence amended).

5.49. Within the ESO ECP, the ESO also recommends that Ofgem carry out additional oversight activities throughout the tender process (e.g. check at specified milestone(s) whether a project continues to be in the best interest of consumers and check on whether the implementation of the tender process is fair and transparent) although the ESO does not specify when in the tender process these should take place. This proposal has been supported by stakeholders in response to the ESO ECP, who noted the Approver could undertake a number of other checks and activities during the tender process to help support decision making at the Stage Gates.

³⁰ The second invitation to tender stage, ITT stage 2, is the final assessment stage of the tender process for early competition. It aims to select a single preferred bidder to progress through to the PB bidder stage. The ESO proposes that ITT stage 2 process is a detailed, forward-looking assessment of the solutions bidders have developed, their plan for implementation and their commercial proposals.

Our views on proposed activities for Ofgem during the tender process

5.50. Whilst we agree with the majority of approval activities at the various tender points, as outlined in paragraph 5.29, we don't agree that Ofgem should be approving the preferred bidder.

5.51. We agree that there should be some form of oversight activities by Ofgem during the tender process, to ensure the tender exercise continues to represent an economic and efficient outcome for consumers. We consider there is a role for Ofgem in overseeing the Procurement Body's roles and responsibilities to ensure that these have been implemented in line with the arrangements agreed with Ofgem (e.g. there have been no material process flaws or negligence, or material changes not agreed by Ofgem).

5.52. We agree with the ESO that it is important that the activities and processes undertaken by both the Contract Counterparty and Licence Counterparty, are aligned as much as reasonably possible. Aligning activities and processes (e.g. contract re-openers) and approval points for each party (e.g. approval of tender documents and 'standard' licence/contract terms) should help towards creating a level-playing field across bidders. However, we need to consider what our role should be with regards to the approval of contracts, to which we would not be the counterparty.

5.53. Our initial view is that we should have no direct role in approving contracts - this should instead be done by the Contract Counterparty. Instead, we consider that our wider Approver role (i.e. oversight as described above, and checking that the project subject to the tender exercise remains needed and in the interests of consumers) should be sufficient. Where we have any concerns as a result of those activities, we would flag those concerns to the Procurement Body and the Contract Counterparty. We will consider this further and would expect to set out information and guidance on this in due course as and when we make decisions on the development and implementation of early competition.

ESO's proposed activities for Ofgem at post-tender stage

5.54. Under the ESO's proposals, Ofgem, as Licence Counterparty, would lead on the PPWCA for network solutions and determine any TRS adjustments. As Licence Counterparty, we would also monitor the licence obligations placed on the successful bidder.

5.55. At the end of the preliminary works stage, our role would be to determine whether there have been any material changes in circumstances, for example to the underlying need for the

project, that would mean it would not be in the interests of consumers to proceed with delivery (i.e. construction) of the successful bidders solution . The information we would consider would include recommendations from the Network Planning Body as to whether the project is still needed in the context of efficient network development, and information from the conclusion of the PPWCA and debt competition. It is our current view that the chances of any such material changes occurring to justify not proceeding with the successful bidders solution are low.

5.56. The ESO's proposals also consider options for the approach at the end of the prescribed revenue period (e.g. re-tender, extension, or decommissioning). However, this is an area which the ESO acknowledges requires further development and the exact parties the ESO proposes are involved in assessing end of revenue options have not yet been finalised. The ESO's initial thoughts are that Ofgem would have two roles at this stage. As Licence Counterparty, Ofgem's role would be to discuss the end of revenue period options (where a licence has been granted) with the ESO as Network Planning Body analysing the options. Once all options have been considered (e.g. re-tender, extension, or decommissioning) a recommendation would then be made to Ofgem as the Approver to determine the best option.

5.57. Throughout the preliminary works, delivery and operations stages, the ESO proposes that our role as Licence Counterparty would be to monitor any licence obligations on the successful bidder and as the decision maker on any matters under their licence (e.g. reopener events, or whether there should be any enforcement action taken).

Our views on proposed activities for Ofgem at post tender stage

5.58. We broadly agree with the activities as set out by the ESO for Ofgem at the post-tender stage. We consider our role at the post-tender stage as Licence Counterparty would align with our existing roles and responsibilities under legislation for managing and issuing licences. We would expect to set out further information and guidance on post-tender stage roles in due course as and when we make decisions on further development and implementation of early competition.

5.59. We need to consider further what Ofgem's role should be post-tender when a contract is awarded. Our initial thoughts are that we see that role focusing only on:

- determining at the PPWCA whether there have been any material changes in circumstances, for example to the underlying need for the project, that would mean it would not be in the interests of consumers to proceed with delivery of the successful bidders solution; and

- determining the best option at the end of the revenue period.

5.60. However, we also need to consider whether there might be a role for Ofgem where there are any disputes and/or considerations of adjustments (money/outputs) under the contract (i.e. between the Successful Bidder and the Contract Counterparty).

ESO proposed roles for TOs in early model competition

Overview

5.61. TOs currently play an important role within the current network planning and development process. There are several different aspects to network planning, although the ESO Early Competition Plan mainly refers to the NOA process and the TOs' role in that (see paragraph 4.13 on how this process is proposed to work in early model competition).

5.62. The ESO has considered the further roles TOs could play, including whether TOs should be allowed to bid in early competitions and any TO roles before, during or after the early competition. This includes taking into account whether TOs would participate in the same way as other bidders (i.e. by submitting a bid on the same terms as other bidders) or whether TOs might instead submit a 'counterfactual' to competition (see paragraph 5.74). As part of the above, the ESO has also considered potential conflicts of interest and whether these could be mitigated.

ESO views on TO participation as a bidder in early model competition

5.63. The ESO considers that ensuring the competition attracts as wide a pool of potential bidders as possible is likely to deliver the best possible outcome for consumers. The exclusion of TOs as potential bidders could lead to a reduction in competitive tension and a potential loss of consumer benefit, particularly as TOs are well placed to deliver competitive bids. It therefore proposes that TOs should be able to bid on the same terms as other bidders, so long as sufficient conflict mitigation measures around the TOs' related roles are able to be implemented to ensure that the tender process is not unfairly balanced in the favour of the incumbent TOs.

5.64. The ESO has highlighted activities where there could be a perceived un-level playing field between TOs' role in network planning, during the tender and as a bidder. The specific activities the ESO has flagged are:

- The initial solution will help set the tender specification. As the TOs are likely to develop the initial solution, the TO will therefore have influence over the tender specification (and whether a project is eligible for competition)
- TOs will have access to relevant information not available to other bidders e.g. TOs will have advance knowledge of the likely tender specification (as their initial solution is likely to drive the specification)
- TOs should undertake feasibility assessments of the impact of proposed solutions on their network. This would give them sight of other bidders' proposed solutions and mean they also assess the impact of bidders' solutions as well as their own proposed solutions
- TOs will have access to RIIO funded resources. This means TOs don't have to take the bidding cost risks that other bidders have to take

5.65. To address the above, the ESO considers two options. One option is to require the ringfencing of TO bidding teams and to introduce ESO challenge of TO initial solution development. The other option is transferring relevant network planning responsibilities for projects that progress to early competition from the TOs to the ESO.

Option 1 – ringfencing of TO bidding teams and ESO challenge of TO initial solutions

5.66. As an initial starting point, the ESO has based its assumptions for how ringfencing for early model competition could work on Ofgem's equivalent TO conflict mitigation proposals for late model competition³¹. The proposed high-level arrangements are:

- Managerial separation of the bidding team from the TO
- Strict rules in place around IT access to prevent TO bidding teams accessing information related to planning functions
- The bidding team must not comprise any employees of the TO who are involved in the development of the initial solutions
- Some physical restrictions of access to shared TO facilities
- Bidding teams are not allowed to recover their costs from regulated revenues

³¹ https://www.ofgem.gov.uk/sites/default/files/docs/2016/11/ecit_november_2016_decision.pdf

- Information relating to tender support undertaken by the TO (e.g. responding to clarification questions) must not be shared with the bidding team
- The TO must confirm its intention to bid and begin to implement conflict mitigation arrangements within eight weeks of the initial approval of projects that will progress to early competition.

5.67. The ESO view is that Ofgem also need to ensure that any impact of competition on TO regulatory obligations is addressed.

5.68. In addition to the ring fencing of TO bidding teams, the ESO considers its role within the NOA process could be strengthened to provide further assurance around conflict mitigation. In practice, the ESO proposes that it would review solutions proposed by the incumbent TOs and challenge the solutions to consider whether they could be brought into scope for competition and ensure the initial tender specification does not unfairly favour TOs. Whilst the ESO already does some challenge and review of TO options through the NOA process, its current role does not normally extend to challenging details that may influence whether projects would be in scope for competition or that might favour TOs in any tender specification. The ESO considers that by equipping it with the capabilities and resources to challenge TO proposed solutions along with the right resources to provide meaningful challenge, this would enable it to:

- Undertake more extensive reviews of TO proposals such as challenging TO delivery dates and proposing different solutions or technologies
- Repackage TO proposed solutions where appropriate such that they meet the competition criteria
- Integrate third party solutions into the overall package of solutions.

Option 2 - Transferring relevant network planning responsibilities for projects that progress to early competition from the TOs to the ESO

5.69. Under this option, the initial planning of NOA options and connection planning functions would be transferred over from the TOs to the ESO. This would mean TOs would no longer produce the initial solutions that determine whether a project should be competed and the specification for the competition, and the ESO would conduct the connection feasibility assessments for each bid, rather than the TO. The ESO view is that this change would represent a significant shift and may also require a significant new function and level of resource for the ESO as the ESO does not currently have necessary expertise to carry out these functions. Additionally, the ESO considers that taking away these functions from TOs could lead to

inefficiencies in network planning, for example reductions in whole system considerations and inefficiencies in solution design.

Our views on TO participation as a bidder in early model competition

5.70. As a general premise, we agree that early competition should be open to the widest range of possible solutions and pool of participants, to compete against each other to address a specified transmission need. By having this widest range of possible participants and solutions, this can help deliver value for consumers by reducing costs, increasing innovation and broadening sources of capital. Our view is that participants should not be excluded from taking part in early competition, unless there are valid reasons for doing so.

5.71. We agree with the ESO proposal that TOs should be allowed to participate as bidders subject to certain conflict mitigation requirements, and there would be value for consumers in taking this approach. In our view the ESO's proposed ringfencing arrangements under option 1 represent a minimum level of mitigation, that may need to go further. These represent the mitigations we have previously proposed for late competition. Under the ESO proposals TOs would play an additional role in early competition (relative to our proposals for late competition). Specifically and as set out earlier, TOs would undertake feasibility assessments of the impact of proposed solutions on their network, which was not a role we envisaged when we considered late competition. For this reason we will need to consider whether there would be any further mitigation arrangements required to reflect this additional proposed TO role. Alternatively, we will need to consider whether it is necessary for TOs to carry the feasibility assessment role, or whether this role could be carried out efficiently by an independent party such as the ESO or a technical consultancy firm.

5.72. In principle, we can see some potential benefits of ESO challenge of TO initial solution development. However, as this would represent a change to the ESO's current responsibilities, we would want to be confident that the ESO could carry out this new function efficiently and effectively.

5.73. We would welcome stakeholders' views on the ESO proposed conflict mitigations for TOs. We would additionally welcome views from stakeholders on what might be an appropriate level of challenge from the ESO on solutions put forward by TOs as part of their network planning role.

TO counterfactual approach

5.74. The ESO's ECP recognises that two of the three TOs have put forward an alternative approach to the one favoured by the ESO in relation to the terms under which TOs would bid in an early competition. For the purposes of this document, we refer to this proposed approach as the "TO counterfactual approach". These TOs consider that the TO counterfactual approach would deliver a better outcome for consumers than the arrangements identified within the ESO's ECP.

5.75. Based on our understanding of the TO counterfactual approach, the process used to identify network requirements would be the same as the process proposed within the ESO's ECP. The difference in the TO counterfactual approach comes at the point at which an early competition tender process starts. Under the TO counterfactual approach, the TO would not bid in through the two-stage ITT process alongside other bidders. Instead, the TO would continue to progress its indicative solution from the NOA process under the existing price control arrangements as it would do currently (this includes having access to pre-construction funding for the development of projects).

5.76. Under the TO counterfactual approach, the early competition tender process for non-TO bidders would be aligned with the assessment stages in place for the TO option under its price control arrangements. The expectation appears to be that whilst the second ITT stage of the early competition for non-TO bidders takes place, an assessment of each TO proposal by Ofgem would also take place. This assessment would be an equivalent assessment to the Initial Needs Case under the LOTI mechanism within RIIO-2. At this point, each TO proposal would be compared to the highest scoring bid from the competitive process for non-TO solutions by Ofgem. The most economically advantageous proposal would be chosen by Ofgem as the winning solution to be taken forward to the preliminary works phase.

5.77. Under the TO counterfactual approach, TOs would also have a role in assessing the feasibility of the competing bids put forward at the first ITT stage (this aligns with the approach proposed in the ECP, as set out in paragraph 5.27).

ESO views on the TO counterfactual approach

5.78. The ESO has highlighted a number of concerns with the TO counterfactual approach. Firstly, under the proposed approach, the TO would undertake a feasibility assessment on

competing bids ahead of finalising its own. The ESO considers that this is a potential conflict of interest and would not be acceptable to bidders.

5.79. Secondly, under this approach, the TO would continue to develop its proposal after the tender has started. If this development is based on additional information that the TO gains access to after the tender process has started, the ESO again considers this a potential conflict of interest and does not consider this would be acceptable to bidders.

5.80. Thirdly, as set out in paragraph 5.75, under the existing RIIO-2 arrangements, TOs have access to funding for the development of projects. The ESO did not think it would be appropriate that the TOs would face a different level of development risk to the bidders that are competing against them.

5.81. Fourthly, the ESO raised a concern that if the pre-construction funding is in place for a project that progresses to early competition, there may be times where the TO can progress its preliminary works for the indicative solution from the NOA ahead of the competing bidders, leading ultimately to the final decision being a comparison of two prospective projects that are at different stages of development. Again, the ESO does not think this would be acceptable to bidders.

Our views on the TO counterfactual approach

5.82. Our understanding is that the TO counterfactual approach has been developed with the aim of allowing for a direct comparison between the status quo RIIO approach and the outcome of an early competition for each project that meets the criteria for early competition.

5.83. In principle we understand the potential benefit of this aim in ensuring that consumers realise the most economically advantageous option for each and every investment in the network. In practice, we do not consider that the TO counterfactual approach would be able to deliver this.

5.84. From a legal and regulatory perspective, it is challenging to see how the TO counterfactual model could be developed in a manner that is clear, transparent and fair³². As

³² If the TO counterfactual approach were progressed, further consideration would also need to be given to any applicable procurement law.

identified by the ESO, the model presented by the TOs appears to involve a number of points in the process at which the role of the TO is likely to be unacceptable to bidders. This is likely to limit the number of bidders willing to spend money bidding into the ITT process, which means the TO is unlikely to face strong enough competition to give a true comparison between the competitive and monopoly TO approaches.

5.85. Given the additional challenges that would need to be overcome, we do not consider the TO counterfactual approach represents an appropriate model to continue developing. The ESO proposal of running a CBA to determine whether it would be in the interest of consumers to run an early competition before the tender starts would appear to address the concerns about ensuring that consumers do not miss out, whilst also allowing a level playing field for all bidders, including TOs, once it has been determined that an early competition will be run. Relative to the ESO's proposed approach, the TO counterfactual approach appears to add complication, through a parallel process giving rise to aspects that are unlikely to be acceptable to bidders.

5.86. It could be argued that the TO counterfactual approach allows for the RIIO alternative to remain under consideration later in the process, and therefore provides additional comfort that the optimum solution is being taken forward. Aside from the limitations that this approach might have on bidders, the comparison between the non-TO bid and the TO counterfactual would be taking place at an early stage in the development of options and would be comparing two different regulatory models with different risk profiles. In addition, the decision point on the winner would come significantly earlier than the needs case assessment would normally take place under the LOTI mechanism. Whilst bidders in the early competition would have an incentive to provide competitive but deliverable bids, it would appear that the TO would be incentivised to reduce the level of cost it estimates would be associated with the project under RIIO. Unless Ofgem amended the RIIO arrangements to apply some mechanisms to contain costs, the TO would face no penalty for subsequently providing more accurate cost estimates and/or more costly alternative project designs after any decision to favour the TO solution under the RIIO model.

6. Tender process and commercial model

Section summary

This Chapter summarises the tender process and commercial model proposed by the ESO in its ECP and our initial views on these proposals.

Questions

Question 1: Do you have any material concerns with the commercial model proposed by the ESO?

Question 2: Do you have any material concerns with the tender process proposed by the ESO?

Introduction

6.1. This Chapter summarises the ESO's proposed commercial model that can be applied to the successful bidder. It also covers the ESO's proposed approach to the design and running of early competitions. It covers the stages of the tender process:

- The pre-tender process: this focuses on ensuring bidders will be able to develop their bids.
- The pre-qualification process: this covers the conditions that a bidder will need to satisfy in order to qualify to be invited to the first Invitation to Tender stage
- The first Invitation to Tender (ITT) stage: this focuses on identifying which solutions put forward by pre-qualified bidders meet the technical and policy needs of the tender and can progress to the second ITT stage.
- The second ITT stage: this focuses on assessing final bids to identify the preferred bidder. The PB stage: this covers the finalisation of arrangements that is undertaken before the preliminary works of the winning solution can begin. This includes the granting of a licence or contract for the successful bidder.

6.2. There remains significant work to be done to finalise further detail on the tender arrangements and detailed commercial model. This work can only be fully completed once the Procurement Body responsibilities have been allocated and once we have made a decision on whether and how to proceed with early competition. For this reason we provide only our initial views on the detail covered in this Chapter, with a specific focus on the elements of the tender

process and commercial model that are fairly unique to an early competition. We will consult on our views on the tender process and commercial model in more detail as and when the early competition roles have been finalised and allocated and the relevant work has been sufficiently progressed.

Commercial model

6.3. The ECP seeks to encourage as wide a range of bidders into the process as possible to drive innovation and deliver value to consumers. This means the chosen commercial model will be critical in ensuring new entrants, who may only ever own a single project, are able to effectively recover their costs.

6.4. Currently, onshore TOs receive allowed revenue under a price control framework. Across their relatively large portfolio of assets efficient TO costs are recovered over a 45-year asset depreciation period with an allowed rate of return (referred to as the Weighted Average Cost of Capital (WACC) based on an assumed level of gearing) applied to the value of the asset base each year. Under these arrangements, cost allowances, WACC and financial incentives are updated at regular intervals (currently 5 years for RIIO-2). We consider this is an appropriate approach for companies that have a relatively large asset base. However, in the case of early competition, the selected commercial model will need to be suitable for a range of specific projects and must ensure that new entrants, who may only ever own a single project, are able to efficiently finance projects and effectively recover their costs. The ECP proposes a revenue model where bidders are expected to bid the revenue they would expect to receive for delivering and operating their project over a fixed duration specified within the competition. This is referred to as a Tender Revenue Stream (**TRS**). The ECP proposes that the duration of the TRS will be aligned with the length of the network need that is being met, capped at a maximum of 45 years to reflect the revenue recovery period for TO assets under the RIIO price control framework.

6.5. The TRS would serve to ensure a level playing field wherever possible, and require bidders to commit to margins and overheads on construction and operation of their project, along with an underwritten equity commitment. Conversely, costs that may be deemed out of the control of the bidder may be updated after the tender process, such as through partially indexing costs (to inflation) or revising some costs after completion of the preliminary works. The TRS would be largely fixed following the completion of the preliminary works, subject only to adjustments as a result of performance against a certain limited number of incentives or where certain limited cost reopeners are triggered.

ESO view on the commercial model

6.6. Following the grant of a licence or award of a contract (as appropriate) the successful bidder would undertake the preliminary works followed by construction, commissioning, operations and maintenance, and decommissioning at the appropriate point in time.

6.7. As its starting point the ESO sought to align with the post tender process we have previously proposed for the late competition model³³. However, the need to cater for the preliminary works stage in particular led to some divergence between the post tender processes for late and early competition models in the ESO's final ECP.

6.8. There are many stages and components to the preliminary works, covering securing planning consents, site surveys, obtaining land rights, supply chain engagements and procurement and incumbent TO engagement, amongst others. The specific details will vary between projects based on the type of solution and what is required to facilitate delivery.

6.9. Once the preliminary works have been completed, the construction, commissioning and operations and maintenance phases and activities are then similar to those previously considered by Ofgem under the late competition model, albeit that there are separate considerations in some instances for non-network solutions coming forward under the early competition model.

6.10. The ESO proposes that as a result of the preliminary works activities there could be changes required to the design, costs and/or programme that was bid at ITT stage 2. These could for example be in relation to any conditions placed on the successful bidder as part of planning consent being granted, or due to site surveys resulting in adjustments to a route corridor. Rather than requiring bidders to price in the full range of risks they are likely to face during the preliminary works stage in an upfront bid, the ESO has proposed a mechanism to allow for the successful bidders revenue to be adjusted to reflect the cost impact of certain changes occurring during the preliminary works phase. This process is referred to as the Post Preliminary Works Cost Assessment (PPWCA) process.

³³ <https://www.ofgem.gov.uk/publications/extending-competition-electricity-transmission-proposed-arrangements-introduce-onshore-tenders>

6.11. The PPWCA process is intended to adjust the revenue of the successful bidder in a targeted way and if specific conditions are met. For example, elements that make up the successful bidders revenue will include an assumed percentage return on equity, margins and overheads and fixed bidding costs that will not be adjusted through the PPWCA process. It is only specific changes to the pre-determined costs of delivering the work as a result of the preliminary works that will be eligible to be adjusted through the PPWCA process. Additionally, since it is likely that the best cost of debt rates will only be available where there is a full understanding of the final allowed costs, the ESO proposes that a common cost of debt assumption set by the Procurement Body is used in ITT stage 2 bids, but is updated for the successful bidder through a debt competition following the completion of the PPWCA process.

6.12. In developing its proposed PPWCA process, the ESO has sought to balance the protection of consumers from cost overruns with ensuring that bidders have confidence that they will not be fully exposed to cost escalations that they may not have control over or could not have reasonably anticipated and so will not be motivated to walk away if problems arise. The ESO has also sought to ensure that bidders remain incentivised to submit accurate and appropriate cost estimates at the ITT 2 stage. The ESO proposes achieving this through a three-stage process during the PPWCA whereby all cost changes resulting from the preliminary works stage are considered on a case-by-case basis:

- Consider whether the cost (and consequent adjustment to TRS) is permissible; for example is it a cost within the scope of the PPWCA and was the reason for a change one that could not have been reasonably foreseen by the bidder?
- For permissible costs, an 'economic and efficient' review to determine a fair adjustment will be undertaken. This may include considering whether any additional costs may be recovered from subcontractors or insurance instead of through the TRS.

6.13. An overall cap (likely set at a % of overall TRS proposed by the bidder) will be set to limit the cumulative cost change resulting from adjusted costs that are allowed. This is designed to ensure that initial cost estimates within the ITT stage 2 process are accurate as any cost increase beyond the level of the cap would not be included in the final PPWCA adjustment to revenue. The ESO notes that some stakeholders suggested the PPWCA process and principles should align to those of similar processes to set capital cost allowances in the onshore arrangements (e.g. Large Onshore Transmission Investment (LOTI)). The ESO has therefore left an option for this to be explored as the PPWCA is developed.

6.14. The ESO suggests that the PPWCA process should be clearly set out ahead of any tenders being run, so bidders are able to understand the process and risk allocation and factor it into their bid TRS. They propose this be done through the development of common guidance between the Contract and Licence Counterparties³⁴, and whilst it would not be a mechanistic view of all possible outcomes it should provide bidders with the key principles under which a review would be carried out.

6.15. Additionally, the ESO proposes that at the conclusion of the PPWCA, a debt competition would be run to set the allowed cost of debt to be factored into the TRS. The ESO proposes that the debt competition would be overseen by the Procurement Body, utilising guidance from the Treasury in relation to preferred bidder debt competitions.

6.16. Whilst some stakeholders took the view that successful bidders should be incentivised to run efficient debt competitions by sharing any reduction in TRS between the bid stage and Financial Close as a result of an improvement in debt terms, the ESO took the view that given the potentially long time period between bid stage and PPWCA it could be extremely difficult to determine what improvement was due to the bidder's initiative and what was as a result of general market movements. This could result in the successful bidder unduly benefiting to the detriment of consumers. Within the ECP the ESO raised the option of evaluating how well a debt competition has been run by the successful bidder, based on a set evaluation framework, to determine whether they should receive an additional reward for the cost of debt they secure.

6.17. The ESO additionally raised the idea of a decommissioning security for successful bidders. The ESO recognised that such a security would come at a cost, expressed through the TRS and ultimately borne by consumers, and acknowledged that a partial or limited security covering only the decommissioning requirements set out in relevant industry codes may have value as a compromise between upfront consumer value and the potential risk on consumers at the end of an asset's lifecycle.

6.18. The ESO proposes that prior to a contract or licence being awarded/granted, the PB would post a performance bond or equivalent form of acceptable security.

³⁴ This is because the ESO proposes that the Contract Counterparty runs the PPWCA for successful bidders that have been awarded a contract; whereas the Licence Counterparty runs the PPWCA for successful bidders that have been granted a licence.

6.19. The ESO has proposed a performance bond in order to reduce the likelihood of a successful bidder walking away post-tender. The ESO has proposed that the performance bond would be forfeit if the successful bidder were to walk away before the project is operational. The ESO sets out that this is intended to address the low-risk but high-impact cost on consumers should the solution not be delivered.

6.20. However, the ESO recognises that the cost of providing this security would be included in the bid, and so put upward pressure on costs for consumers. To balance these two factors the ESO proposes a tapering value performance bond, whereby the value is highest in the preliminary works stage and decreases towards the commissioning date, with the reduction in value tied to either time elapsed or project spend.

Ofgem view on the commercial model

6.21. We recognise that given the cost uncertainty faced by bidders ahead of the preliminary works stage, allowing for aspects of the bids to be updated once the post preliminary works are complete may allow for more efficient bids and more efficient overall costs for consumers. We are comfortable with the idea of the PPWCA to work towards fixing costs ahead of solution construction and welcome the general principle of a cap to limit the risk to consumers of bidders over-promising and/or under-delivering. We acknowledge that the ESO raises the importance of greater engagement with potential bidders over the PPWCA process and cap and the need for further consultation on its proposals. It will be important that the detailed arrangements that make up the PPWCA are understood by bidders, with clarity on which costs are eligible ahead of the start of any early competition tender. We agree that the final PPWCA arrangements will need to appropriately balance the protection of consumers from cost overruns with ensuring that bidders have confidence that they will not be fully exposed to cost escalations that they may not have control over or not have reasonably anticipated. We also agree that the cap will need to be set at a level that ensures bidders remain incentivised to submit accurate and appropriate cost estimates at the ITT 2 stage. We would expect to work with the ESO to help achieve these objectives. For example, we would consider the existing cost assessment frameworks that we have in place under the OFTO regime, the LOTI mechanism and interconnectors subject to our Cap and Floor regime. To assist with this work, we welcome views from stakeholders on whether they have any material concerns with the arrangements proposed by the ESO.

6.22. We are comfortable at a high level with the ESO's proposals on debt competitions, and agree that an incentive based on the outcome of debt competitions is unlikely to be a meaningful way of encouraging or rewarding high quality debt competitions given the length of

time between bidding and PPWCA. We do not yet have a view on an evaluation framework and incentive on the quality of debt competition, and would welcome any further detail in due course from the ESO on what this might look like as and when the commercial model is developed in further detail.

6.23. We recognise the benefit of ensuring that there is a mechanism in place to protect the interest of consumers regarding the risk of non-delivery. A performance bond, as proposed by ESO, could be an effective way of doing this, but the exact calibration and detail of this arrangement is likely to have an impact on the extent to which this increases the revenue streams proposed by bidders.

6.24. As and when the commercial model is developed in further detail, we would welcome further information in due course from the ESO on the proposed performance bond and how it might work in practice, and a more detailed consideration of the impact it may have on bids and bidder behaviour.

Pre-tender process

6.25. Under the ESO's proposals the pre-tender process takes place following the identification of a suitable project that meets the criteria for early competition. The pre-tender process focuses on project information sharing, procurement support activities, and deciding the terms of the commercial model and bid evaluation process.

6.26. The sharing of project information through events and services helps to inform potential bidders on the specification details and technical requirements of a project, such as the indicative solution, and allows potential bidders to raise questions. The Procurement Body and Network Planning Body would share all technical details, including system requirements, length of need and geographical boundaries.

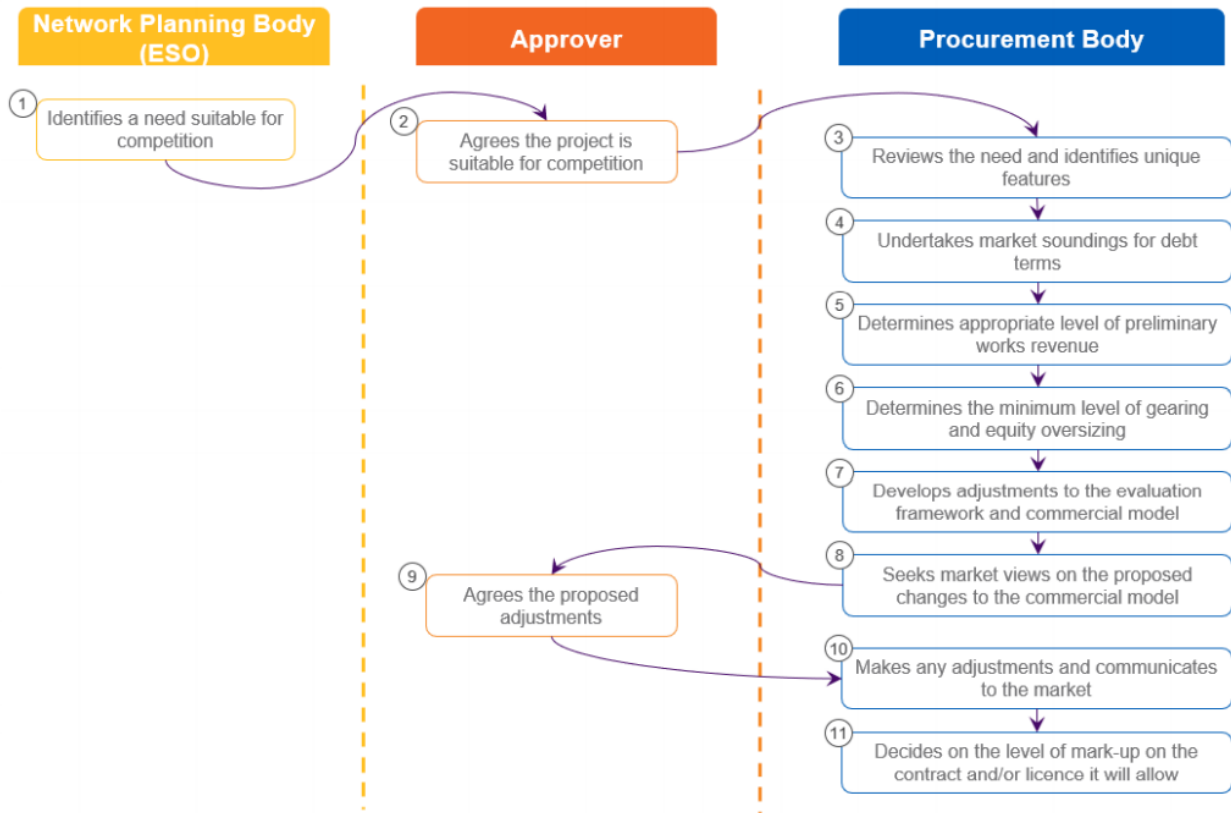
6.27. Procurement support ensures potential bidders are appropriately prepared to develop their bids and enter the procurement process. This would include sharing details of the procurement process, evaluation criteria, commercial model, licensing and contractual documentation and submission interactions.

ESO view on adjusting the commercial model and bid evaluation framework

6.28. The ESO's view is that the ECP presents a standardised approach to the commercial model and bid evaluation framework that can be reviewed on a case-by-case basis. The rationale for this proposed approach is that the range of needs and projects under early competition could be very wide in terms of scale, time sensitivity and geography. To ensure that early competition delivers value for consumers it is important that the tender process and commercial arrangements are proportional and reflective of the underlying need.

6.29. The ESO considers that the specific details of the procurement process and commercial model for a project can be refined during the pre-tender process depending on the nature of the project to be tendered. This may involve for example adjusting the expected timeline of the overall tendering process or any particular stage, or an adjustment of the bid evaluation criteria to reflect the differences between projects, such as between projects of different levels of complexity or expected cost. The ESO has also set out that the length of the revenue term would be likely to adjust based on the need on the network the competition is designed to address.

Figure 4 – ESO proposed process for adjusting the commercial model and bid evaluation process



Ofgem view on pre-tender process and adjusting the commercial model and bid evaluation framework

6.30. Overall, we are comfortable with the pre-tender process proposed in the ECP. We consider it sensible to retain flexibility in setting the bid evaluation framework and/or commercial model due to the potential variety in nature between projects that may undergo an early competition process. Our initial view is that the proposed process for adjustments, and the principles for enacting adjustments, are reasonable.

6.31. However, there is a balance to find between flexibility in the process and in establishing familiarity with the framework to facilitate learning by all stakeholders in the process. For example, given the wide range of solution types that might win an early competition, there may be a case for setting bid evaluation weightings on a project-specific basis tailored to the expected technical or locational difficulties of each tender scope. This could be beneficial for a

specific project in isolation, but a more common set of established weightings could be beneficial in providing greater consistency in how bids are evaluated, which should allow bidders to improve their bids over time as they get more confident with the evaluation framework. We understand the ESO is aware of this trade-off and would welcome views in due course as and when more detailed tender arrangements are developed on how best to balance the benefits of different approaches to making adjustments to the evaluation framework or commercial model, including whether there should be limits on any of these.

Pre-qualification (PQ stage)

6.32. Pre-qualification is the stage of the tender process where bidders are evaluated and, those that pass, subsequently progress to the invitation to tender stage (part 1). As part of its ECP, the ESO have considered how this stage may work in practice.

6.33. ESO have considered what evaluation criteria may be used to assess bidders at the PQ stage. These criteria include financial capacity, technical capability and minimum corporate standards. It has considered whether these criteria are best applied through a pre-approved passport, how best to efficiently deal with consortia that change over time, how the assessment will be carried out, and how it can be aligned with Ofgem's licensing process in order to ensure that the process can take place as smoothly and provide as much certainty for bidders as possible, as early as possible (see Figure 5 for a complete breakdown).

Figure 5 – ESO’s proposed PQ stage requirements for potential bidders

Area	Information	Bidder
Company details	<ul style="list-style-type: none"> Name of bidder Company registration Date of registration in country of establishment Place of incorporation Trading status 	All
Group Details	<ul style="list-style-type: none"> Immediate parent company details Ultimate parent company details 	All
Shares, advisors and licences	<ul style="list-style-type: none"> Details of directors of bidding entities Significant shareholders of bidder members Legal, financial, technical adviser details Other licences held by the bidder 	All
Details of grounds for exclusion	<ul style="list-style-type: none"> Any individuals with the bidders who have the conviction of criminal activity, corruption, fraud, terrorism, money laundering or child labour Breach of tax obligations, environmental obligations, social obligations and labour law obligations Bankruptcy or insolvency Distortion of competition/role in the procurement process Deficiencies in performance in a prior contract Subject to UK/EU sanctions Previous breach of an NDA by any company in the group 	All
Consortia	<ul style="list-style-type: none"> Bidder group organisational structure Organisation which will hold the electricity transmission licence/contract Relationship between each bidder group member Key contractual relationships 	Lead bidder

6.34. The ESO’s recommendation is that bidders are assessed on a range of criteria as part of the PQ stage. Each member of the bidder group would be expected to provide information on company specific information as set out in Figure 5. For consortia the lead bidder would be asked to provide information on the consortia, including their financial capacity to secure financing solutions through a variety of agreed means.

Ofgem view on PQ stage proposals

6.35. We broadly agree with the proposed approach to the PQ stage, and note that the majority of stakeholders who responded to the ECP share this view. However, we are seeking views from a wide range of stakeholders as part of this consultation on whether they have any material concerns with the arrangements proposed by the ESO.

Invitation to tender stage 1 (ITT stage 1)

6.36. The ESO proposes that a two-stage ITT is the most appropriate approach to take for early competition. The first ITT stage would be an initial tender stage for early competition. The aim of the ITT (stage 1) is to down-select the number of bidders which progress to the second stage. At this first stage, bidders would submit an initial solution design that demonstrates how it meets the need and that it is a suitable technology.

6.37. The ESO considers that initial solution designs at ITT stage 1 are expected to be relatively low cost to produce in comparison to more complex and detailed proposals submitted at ITT stage 2. ITT stage 1 submissions would also take significantly less time to produce and assess. The ESO's view is that having a two-stage ITT in this way would allow more potential participants to engage and be assessed alongside competing ideas before the need to develop and submit costly and time consuming detailed plans at ITT stage 2.

6.38. The ESO's view is that submissions would be assessed at ITT stage 1 against the criteria of: meeting the network need, risk to network reliability, deliverability and environmental and social impacts. The ESO has proposed using a simple 'pass' or 'fail' assessment based on a minimum threshold score for each of the four criteria. The ESO considers that this ensures all solutions that meet the tender technical requirements progress to the second ITT stage.

6.39. Where there are a high number of bidders participating in ITT stage 1, relative scoring might be introduced to limit the number of solutions proceeding to ITT stage 2.

6.40. The ESO has proposed that cost estimates will not be assessed at the first ITT stage as they consider that it would lead to an increase in bidder costs or could lead to gaming of the tender process. If cost estimates were assessed but bidders were not expected to be held to them, then bidders may be encouraged to submit unrealistic cost estimates. If bidders were held to cost estimates, then far more detailed feasibility and planning studies would need to be carried out which would lead to significantly increased bid costs, and potentially require a lengthened timeline for ITT stage 1 (or the need to run a single-stage ITT instead).

Ofgem view on ITT stage 1

6.41. We broadly agree with the ESO's proposed approach to ITT stage 1. We note that there was broad stakeholder support through the ECP for the four criteria proposed for assessing submissions at this stage, and we agree that they seem reasonable; although we would want

to consider this in further detail in due course as and when the early competition model develops.

6.42. We agree in principle with the use of relative scoring where there is a high number of bidders at ITT stage 1, as having too great a number of solutions proceed to ITT stage 2 could deter bidders from participating in ITT stage 1 or 2 if they perceive a low likelihood of progressing or winning. We also note that this point was raised by stakeholders in responses to the ECP.

6.43. Additionally, we agree that seeking too many detailed proposals at ITT stage 2 might create a lengthy and resource intensive assessment. Progressing too many solutions to ITT stage 2 may result in a significant increase in the total costs of running the competition process.

We are broadly supportive of the ESO's proposed exclusion of cost estimates at ITT stage 1, and agree with its reasoning that doing so could either create perverse incentives on bidders to submit unrealistic figures or lead to a significant increase in the cost of producing a submission.

Invitation to tender stage 2 (ITT stage 2)

6.44. The second invitation to tender stage, ITT stage 2, is the final assessment stage of the tender process for early competition. It aims to select a single preferred bidder to progress through to the PB stage. If no overall preferred bidder is identified, then a Best and Final Offer (**BAFO**) stage may be additionally required.

6.45. The ESO proposes that the ITT stage 2 process is a detailed, forward-looking assessment of the solutions bidders have developed, their plan for implementation and their commercial proposals.

6.46. The ESO has proposed that bids will be assessed on both technical and commercial elements using a predefined methodology and set of weightings. To support the commercial assessment, bidders must submit a financial model from which an indicative TRS can be calculated.

6.47. The technical assessment is proposed to be on the basis of seven key technical areas, each scored between 0-5 depending on the level and quality of evidence provided. It is expected that the Procurement Body and Network Planning Body would provide participating bidders with all relevant information that they are legally able to share, in order to develop their bids, It is

not expected that bidders would not need to undertake duplicated work, for example; additional surveys.

6.48. The ESO's proposal is to integrate the technical scores bidders receive based on the plans they submit with the TRS. The ECP proposes that, for the purposes of evaluating bids only, a pre-determined percentage of each bidder's TRS will be adjusted as a result of its overall technical score. This would result in a single 'Technical Adjusted TRS'. For example, if two bidders submit comparable TRS proposals, but one gets a higher technical score, this bidder would get a lower Technical Adjusted TRS. The bidder with the lowest Technical Adjusted TRS would be selected as the preferred bidder and progress to the PB stage.

Ofgem view on key point(s) of ITT stage 2

6.49. We agree with the approach of assessing the bids on both technical and commercial elements, and forming an overall combined view from which to select a preferred bidder.

6.50. We have not yet formed a view on the specific technical areas on which solutions will be assessed, and the associated scoring methodology. We anticipate seeking views from stakeholders on the detailed arrangements as and when the early competition model is developed further. We would however, welcome views in response to this consultation from stakeholders on whether they have any material concerns with the arrangements proposed by the ESO.

Preferred bidder (PB) stage

6.51. The PB stage is when a single preferred bidder has been selected and there are several steps which must be undertaken prior to the conclusion of the tender process. These would include finalisation of the contract and/or licence; commercial, technical and legal due diligence; and entering into agreements to abide by relevant industry codes and standards.

6.52. Once the preferred bidder has been determined, the ESO proposes in the ECP that feedback would be provided to unsuccessful bidders on their scores and their bids, and time allowed for challenging the outcome of a tender before the preferred bidder is confirmed. At the end of the PB stage the ESO proposes that there would be a standstill period of 10 days after feedback to unsuccessful bidders and where a licence is granted, a statutory consultation period.

6.53. As set out in paragraph 6.18, the ESO proposes that prior to a contract or licence being awarded/granted, the PB would post a performance bond or equivalent form of acceptable security.

ESO proposed arrangements in the event of a competition process failure

6.54. In the ECP, the ESO sets out its proposed arrangements to be applied where there is a competition process failure. The ESO identifies three potential process failures in the ECP:

- 1.** A failure in the tender process (e.g. limited liquidity in the competition leading to materially higher costed bids than expected, or no bidders meeting the requirements at a stage of the tender).
- 2.** A failure in the preliminary works or construction phase of delivering the successful bidders solution
- 3.** A failure during the operational period of the successful bidders solution.

6.55. In all of these circumstances, where there remains a need to be addressed on the network, it will be necessary to ensure that contingency arrangements are in place. Where feasible this could include a re-running of a tender process (either repeating a stage or a full re-run), but could require additional measures, including the appointment of an alternative party to address the network need. Depending on the stage at which the failure occurred, this might involve the alternative party proposing and delivering an alternative solution, or taking over responsibility for existing works and assets.

6.56. Standard Conditions B18 and E21 of the Transmission Licence and the associated guidance³⁵ set out the provisions of the OFTO of Last Resort mechanism for the OFTO regime. This is the last resort approach available for OFTO failures, including a failure in the tender process. Under the mechanism Ofgem would direct an existing licensee to take responsibility for the project for a limited period of time before a more permanent arrangement was put in place (for example, running another competition to determine another party to take longer-

³⁵ <https://www.ofgem.gov.uk/publications/guidance-offshore-transmission-owner-ofto-last-resort-mechanism>

term responsibility for the project). We proposed that similar 'CATO of Last Resort' arrangements would be put in place as part of our development of late competition.

6.57. The ESO highlights that further work is needed to finalise the last resort arrangements under early competition. However, where the failure relates to a solution requiring a transmission licence, it references the OFTO of Last Resort mechanism and guidance and proposes that it could be amended to include arrangements for equivalent failures under an early competition model.

6.58. In the case of any competition process failure relating to solutions that do not require a transmission licence and that occur after the successful bidder has been appointed, the ESO considers that it is not likely to be appropriate to direct a licensee to take responsibility for the project under last resort arrangements. The ECP considers whether in such instances the case-by-case consideration of enhanced risk management arrangements may be a more effective means of addressing the risks associated with competition process failures.

Ofgem views on the ESO's proposed arrangements in the event of a competition process failure

6.59. We agree in principle that the OFTO of Last Resort mechanism is the appropriate starting point to developing equivalent last resort arrangements for early competition. As and when the early competition model is developed further, we would engage further with the ESO to develop a more detailed set of proposals for how those arrangements should be developed.

6.60. We would also engage further with the ESO to consider how equivalent arrangements, or alternative approaches such as enhanced risk management arrangements, could best be applied in the case of solutions that do not require a transmission licence.

7. Next Steps

7.1. This consultation is scheduled to close on 9 September 2021. Following consideration of responses to this consultation, we expect to confirm by early 2022 whether the early competition model should be finalised so that it is capable of being implemented within the RII0-2 arrangements, and if so reach our mind-to decision on who should carry out each role within early competition and what the process for identifying suitable projects for early competition should be.

7.2. As referenced in our May 2021 Update on early competition, we have agreed with the ESO proposal for it to continue to carry out low regret work this year relating to the further development and implementation of early competition. As and when it is available we will factor any additional work carried out by the ESO into our decisions and plan referred to above.

7.3. Should we decide to proceed with early competition, more detailed tender policy and arrangements would need to be developed and finalised ahead of any early competition tenders in the future. This would also include the final details relating to any project-specific cost-benefit analysis. We would also expect to make decisions and develop further information and guidance on a range of other areas including conflict mitigation requirements, licence changes and draft licences for successful bidders, and details on how Ofgem's existing processes and requirements would interact with early competition.

Appendices

Index

Appendix	Name of appendix	Page no.
1	List of consultation questions by Chapter	75
2	Privacy notice on consultations	75

Appendix 1 – List of consultation questions by Chapter

Chapter 3: ESO's Early Competition Plan

Question 1: Do you agree that the continued development of the arrangements to allow early competition in electricity transmission represents good value for money for consumers?

Chapter 4: Identifying which projects are suitable for Early Competition

Question 1: Do stakeholders have any views on how a very early competition could be accommodated within the network planning process without having a detrimental impact on the planning of the rest of the network, or whether there are any specific network situations where a very early competition could be run for a solution without it having a detrimental impact on the planning of the wider network?

Question 2: Do you agree with our assessment of the ESO's proposed process for defining the technical scope of a tender under an early competition?

Question 3: Do you agree with our assessment of the ESO's proposed criteria for early competition? Specifically, do you have any views on whether:

- there is a need for a 'high value' criterion?
- 'new' and 'separable' are necessary or appropriate as specific criteria for identifying projects for early competition?

Chapter 5: Roles and Responsibilities within Early Competition

Question 1: Do you have any material concerns about the ESO's expertise, incentives, or independence, should they be appointed to carry-out the Procurement Body role for early competitions?

Question 2: Do you agree with Ofgem's proposed roles?

Question 3: Who should undertake the network planning body role? What role should TOs play in network planning?

Question 4: What are your views on the proposed conflict mitigation arrangements for TO roles? What might be an appropriate level of challenge from the ESO on solutions put forward by TOs as part of their network planning role?

Question 5: Do you agree with our views on the TO counterfactual approach?

Chapter 6: Tender process and commercial model

Question 1: Do you have any material concerns with the commercial model proposed by the ESO?

Question 2: Do you have any material concerns with the tender process proposed by the ESO?

Appendix 2 – Privacy notice on consultations

Personal data

The following explains your rights and gives you the information you are entitled to under the UK General Data Protection Regulation (UK GDPR).

Note that this section only refers to your personal data (your name address and anything that could be used to identify you personally) not the content of your response to the consultation.

1. The identity of the controller and contact details of our Data Protection Officer

The Gas and Electricity Markets Authority is the controller, (for ease of reference, "Ofgem"). The Data Protection Officer can be contacted at dpo@ofgem.gov.uk

2. Why we are collecting your personal data

Your personal data is being collected as an essential part of the consultation process, so that we can contact you regarding your response and for statistical purposes. We may also use it to contact you about related matters.

3. Our legal basis for processing your personal data

As a public authority, the GDPR makes provision for Ofgem to process personal data as necessary for the effective performance of a task carried out in the public interest. i.e. a consultation.

4. With whom we will be sharing your personal data

We may share consultation responses with BEIS. Please note that responses not marked as confidential will be published on our website. Please be mindful of this when including personal details.

5. For how long we will keep your personal data, or criteria used to determine the retention period.

Your personal data will be held for for six months after the project is closed, including subsequent projects or legal proceedings regarding a decision based on this consultation, is closed.

6. Your rights

The data we are collecting is your personal data, and you have considerable say over what happens to it. You have the right to:

- know how we use your personal data
- access your personal data
- have personal data corrected if it is inaccurate or incomplete
- ask us to delete personal data when we no longer need it
- ask us to restrict how we process your data
- get your data from us and re-use it across other services
- object to certain ways we use your data
- be safeguarded against risks where decisions based on your data are taken entirely automatically
- tell us if we can share your information with 3rd parties
- tell us your preferred frequency, content and format of our communications with you
- to lodge a complaint with the independent Information Commissioner (ICO) if you think we are not handling your data fairly or in accordance with the law. You can contact the ICO at <https://ico.org.uk/> , or telephone 0303 123 1113.

7. Your personal data will not be sent overseas

8. Your personal data will not be used for any automated decision making.

9. Your personal data will be stored in a secure government IT system.

10. More information For more information on how Ofgem processes your data, click on the link to our "[Ofgem privacy promise](#)".