

SP Transmission's Response: Consultation on our views on Early Competition in onshore electricity transmission networks

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?

We strongly question whether Ofgem have ensured that the continued development of Early Competition will ensure delivery of Net Zero at the best value for the consumer. As we have set out in detail in our covering letter, the proposals appear to us to significantly increase the complexity of developing, operating and maintaining the transmission network, with consequential impacts on security of supply risk and potentially public safety, and could compromise the efficiency and economy of the transmission network. Again, we question whether increasing such risks is consistent with delivering good value for money for consumers.

Ofgem's draft Impact Assessment for continuing the development of the Early Competition policy contains limited evidence and fails to robustly make the case for consumer value to justify introducing Early Competition as proposed by Ofgem. Indeed, given we do not believe that the Impact Assessment provides evidence of value for money for consumers, we also question whether the continued development of Early Competition is consistent with Ofgem's principal statutory objective under Section 3A of the Electricity Act 1989 (the **1989 Act**) to protect the interests of existing and future consumers, including with regard to their interests in the reduction of greenhouse gases. Our key concerns with Ofgem's Impact Assessment are as follows:

Benefits Case for Early Competition

We note that Ofgem have chosen to base their benefits case largely on just two projects that were carried out in North America: the Hartburg-Sabine Junction and the Duff-Coleman projects. From this, Ofgem have calculated that the savings from this small sample on the indicative cost of an initial reference design could be between 22-42%. Ofgem have then taken the bottom end of this number and applied it to different project values to estimate the savings that Early Competition, if applied to UK Transmission projects, could bring. There are a number of issues with this approach.

At the outset, the regulatory regimes in North America are not comparable to the regulatory regime in the UK, and therefore the benefits that can be derived from running a similar competition will be different. This makes a direct comparison for the purposes of an Impact Assessment challenging. For this reason, we struggle to understand how Ofgem could use this evidence as the primary justification for its Early Competition policy in the Impact Assessment. We explain further below.

The purpose of effective monopoly regulation is to mimic a competitive market. RIIO (Revenue = Incentives + Innovation + Outputs) is a particular form of incentives-based regulation which has been developed by Ofgem over successive years. Ofgem at the final determination for RIIO-T2 stated that it is “*challenging companies to be as efficient as possible in how they run and finance themselves*”. This is evident from a number of elements in the RIIO price control framework that do not exist in global counterparts, including North America where more traditional cost-of-service regulation is used. Other characteristics of this form of regulation include limited incentives on companies to improve their efficiency and service as profits are fixed. Also, in most cases, cost allowances are set based on outturn costs for a base year and projected forward, without explicit efficiency factors that reduce allowance over time. Cost-of-service regimes also incorporate greater use of cost pass-through or true-ups.

Overall, cost of service regulation focuses on achieving a particular type of allocative efficiency, whereas the UK approach has traditionally focused on productive and dynamic efficiency. Price-cap regulation gives strong incentives for suppliers to improve cost efficiency, as until the time that prices are next adjusted.

Other key aspects of the RIIO framework, which differ from the comparators Ofgem has chosen, are as follows.

TOTEX Efficiency Incentives: This gives network companies an incentive to seek the most cost-effective solution and encourages them to contract for services with third parties that can drive down project costs, resulting in a win-win-win scenario for the utility, third parties and consumers. SPT have proven that this results in success, with almost 96% of regulated transmission construction activities delivered by the market¹.

Innovation: Ofgem played a significant role in promoting innovation within the energy sector through the three innovation stimuli in the RIIO-1 price control: Network Innovation Allowance (NIA), Network Innovation Competition (NIC) and Innovation Roll-out Mechanism (IRM). In their Impact Assessment, Ofgem agree that this has been successful: “*Evidence from the Network Innovation Competition (NIC) and Network Innovation Allowance (NIA) during the RIIO-1 price controls demonstrates that there are a range of innovations on the transmission and distribution networks that are under development, and will continue to be developed to unlock additional benefits to consumers.*”

Ofgem has committed to continue supporting innovation in RIIO-2 through continuation of the NIA fund, the Innovation Roll-Out (IR) allowance through business plan justification and the setting up of a £450m Strategic Innovation Fund (SIF) for RIIO-2, which will replace NIC.

Cost of Capital: The RIIO-T2 regime established an allowed regulatory equity return of 4.02% (CPIH-real and excluding the 0.22% Outperformance Wedge adjustment) for 2021-2026. This allowed return for equity investors represents a significant reduction from that allowed under the RIIO-T1 regime of c.8%.

¹ https://www.spennergynetworks.co.uk/userfiles/file/Annex_18_Competition_Plan.pdf

The sharp decrease in the allowed cost of equity in RII0-2 makes the case for investment in networks in Great Britain materially less attractive. In particular, other international jurisdictions offer more attractive rates of return relative to GB, with Spain providing a return of 5.8% (on an equivalent basis) and the US allowing returns on equity between 7-9%. Indeed, the Federal Energy Regulatory Commission (FERC) established in 2020 for Mid-Continent ISO electricity transmission, an allowed return on equity of 10.02%, which can increase to 12.62% for specific assets, if certain conditions are met.

Conclusion: Given the above points, we do not believe it is appropriate for Ofgem to assume that carrying out a similar type of competition under a different regulatory regime will equate to the same level of benefits being realised.

More generally Ofgem and its predecessors have developed a regulatory framework for electricity networks since vesting and privatisation which has evolved over time to ensure that networks deliver a highly reliable, safe secure and stable supply of electricity to GB electricity consumers. Robust evidence and careful consideration are essential before implementing such a fundamental alteration of this framework, as Ofgem is proposing. Ofgem has not properly considered all of the risks of these proposals in its assessments.

'General Benefits' of Competition

Much of Ofgem's Impact Assessment evaluates theoretical ways in which Early Competition could lower costs for consumers. These arguments are based on an underlying assumption that competition will deliver solutions cheaper than the incumbent TO, which contradicts Ofgem's entire regulatory regime.

For example, Ofgem's Impact Assessment states *"Effective early competitions can allow new and efficient solution types to solve issues arising from network constraints, including novel non-network solutions. This can result in lower costs and better value for consumers as bidders seek to create innovative and cost-saving solutions in order to submit competitive bids."*

However, it is not clear why Early Competition should be a more efficient means of setting long-term commitments and incentives for the provision of infrastructure assets, than under RII0. Incentives-based economic regulation (e.g. UK energy network regulation) is a tried and tested system designed to cope with the "incomplete" nature of long-term agreements. For example, experience from the Private Finance Initiative (PFI) and other similar international regimes has shown cases of cost-escalation and/or under-pricing, with providers walking away from their contract, declaring bankruptcy, or giving up a franchise contract². This would likely cause substantial delay and could potentially jeopardise commitments made for meeting Net Zero (further detail on this point is contained within our covering letter). Alternatively, bidders may submit bids at the upper-bound of forecasted costs to avoid these problems and mitigate their exposure to risk. The National Audit Office refers to this type of strategy as bidding a "cost premium for risk transfer", i.e., a contingency allowance built into the contract price, in return for transferring risk onto the provider³.

² NERA (March 2018), Why PFI holds no lessons for utility regulation

³ NAO (Jan 2018), PFI and PF2: Report by the Comptroller and Auditor General, HC 718, Session 2017–2019, para. 1.23, p. 18.

The time and cost risks associated with projects becomes clearer and better quantified as a project develops. Under the Early Competition model, the awarding of the contract/licence at an early stage will inevitably mean that credible bidders will be required to cover these exposures by including significant cost and risk premiums with their bids. This is likely to increase customer costs rather than revealing the efficient level of expenditure.

Furthermore, Ofgem make a number of comparisons which attempt to strengthen their case for Early Competition, which we do not consider relevant. For example, Ofgem have said that the growth of Independent DNOs (IDNOs) and Independent Connection Providers (ICPs) in the distribution connection market shows that there is appetite for parties to compete for work on the electricity network. We do not believe that this is an appropriate comparison, given the difference in the type, scale and complexity of assets that IDNOs and ICPs own – typically smaller, individual networks with limited complexities which are connected to the wider system - in comparison to what is being proposed under Early Competition. Ofgem also make comparisons to the OFTO regime. Again, we believe this is inappropriate given that OFTOs, to date, have not designed, consented or constructed the infrastructure they operate – OFTOs adopt already constructed and commissioned assets. In addition, the planning, design, development, operation and maintenance of radial circuits connecting a single customer is not comparable in complexity to operating the main, interconnected transmission system.

Neither Ofgem nor the ESO have undertaken any exercise to determine whether there is appetite in the market to participate in the Early Competition process itself. The ESO suggest that this should be done by the Procurement Body prior to projects being progressed to Early Competition. However, it is imperative that Ofgem assess the appetite for third parties to participate in Early Competition at an earlier stage. Without this, the case for introducing the model at all is weak.

We believe the model undermines whole systems thinking, to the detriment of existing and future consumers. TOs currently make investment decisions to meet several complex, moving needs on the network, that is in the best interests of consumers on a long-term basis. This is only possible with a holistic view of the network. The Early Competition model could lead to piecemeal solutions to individual network needs. This approach is not aligned to current thinking in other areas of Ofgem's remit. Further, the operational risks of moving to such an approach should not be underestimated – such system operability risk necessarily increases where the number of entities involved in system activities increases. We do not think the draft Impact Assessment gives due regard to these as part of the analysis undertaken, particularly in relationship to the key issue of security of supply. We discuss these concerns further in our covering letter.

One Off Development Costs and Costs of Running a Tender

We note that Ofgem use the ESO's cost estimates in the Impact Assessment. The ESO themselves note that *"these costs are purely indicative and would require further work to substantiate"*. We therefore believe that it is inappropriate to use these costs in the Impact Assessment without further analysis being undertaken.

Notwithstanding the above, Ofgem note that *“it will take a very limited level of investment being subject to early competition before the expected benefits that early competition can deliver are likely to comfortably exceed the estimated development costs of £5.3m - £6.9m”*. However, there are a number of circumstances noted in Ofgem’s own analysis where the net benefit to competition would be negative, or very small, as shown in Table 5 and Table 6 within Ofgem’s Impact Assessment.

Project Specific CBA

Ofgem have highlighted a number of areas representing risk, and therefore cost, that they have not included in their Impact Assessment. For example, risks relating to security of supply and late delivery of projects, as well as the potential for increased risks to safety. Ofgem’s justification for omitting these costs is that they will be factored into the project specific Cost Benefit Analysis (CBA), which we understand Ofgem have asked the ESO to develop between now and December 2021. These factors are likely to represent significant costs, for example, as a result of introducing lengthy delays to the delivery of major Net Zero infrastructure.

We question what timelines Ofgem are assuming for the Early Competition process. Without further clarity from Ofgem, we assume the timeline continues to be the same as suggested in the ESO’s Early Competition Plan, which suggests that the Early Competition process could take approximately 2.5 to 3 years from the NOA assessment stage to select a preferred bidder.⁴ Further delays to project delivery seem inevitable due to the technical and commercial complexity of tendering and awarding/negotiating contracts/licenses, in addition to the delays associated with the bringing into effect of necessary legislative change which will be essential to implement Ofgem’s proposals. As per our response below to Chapter 6: Question 2, we also believe that the model will introduce further delays due to consenting works. Such delays are likely to be costly to consumers and generators alike, and risk undermining the UK’s ability to meet its Net Zero targets on time. Analysis in 2019 showed a one-year delay on the first Eastern Link would cost GB consumers an average of £330m in constraint costs⁵.

There are a number of other costs that we believe should be factored into the CBA that have not been discussed through the consultation process to date, neither by Ofgem nor the ESO. We look forward to sharing our views with the ESO as they develop this further between now and December 2021. Some examples of the types of costs we believe should be incorporated into the CBA include:

- Duplication of black-start resilient control centres with disaster recovery facilities;
- Duplication of telecoms infrastructure;
- Additional cyber security costs related to interfacing with multiple other TOs;
- Duplicated fault response staff and infrastructure across multiple TOs in the same geographical area;
- Requirement to be a full party to the STC:
 - Providing connection offers and affected TO offers for connections;

⁴ [Early Competition Plan 2021 \(nationalgrideso.com\)](https://www.nationalgrideso.com/early-competition-plan-2021)

⁵ [Ofgem EHVDC INC Consultation \(ofgem.gov.uk\)](https://www.ofgem.gov.uk/consult/condocs/ehvdc/inc/ehvdc-inc-consultation)

- Participation in the NOA and ETYS processes;
- Costs of full annual RRP (and its ongoing development) and other TO requirements such as NARM.

Therefore, without having sight of the CBA methodology and its application, it is impossible to understand the likelihood of Early Competition achieving benefit 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?

We agree with the ESO that a very Early Competition would not be practical. There are a number of issues with introducing a very Early Competition that would lead to it being unsuitable in all circumstances. For example, a proposed solution is likely to be influenced by multiple network drivers. A 'very early' tender is less likely to generate efficiencies by considering multiple drivers to meet a particular network need during the design phase. This is something that TOs undertake as part of their usual planning cycle, as there is normally an inter-dependency between solutions that must be addressed in network planning studies.

We therefore consider that very Early Competition cannot be introduced without have a detrimental impact on the planning on the rest of the 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?

We believe that there are a number of practical challenges with using the NOA process that neither Ofgem nor the ESO have identified in the Early Competition model. In our experience, a project which may be considered of appropriate scope, scale and programme in one NOA may be:

- i. Required much earlier in the next NOA, no longer leaving enough time to continue the Early Competition process, without adverse impacts, additional costs and delays;
- ii. The project scope may no longer be appropriate i.e. the proposed capacity may be too high or too low;
- iii. The network need could disappear or change; and
- iv. With projects receiving 'proceed' or 'hold' signals, we query whether this is the right type of process to engage market participants, given this level of uncertainty.

Furthermore, there is a more general acknowledgement across industry that the current NOA process is not delivering for consumers. For example, the ESO have developed a 5-point plan to manage constraints on the system, in light of the NOA not being able to bring transmission infrastructure forward quickly enough to mitigate escalating constraint costs. Therefore, the

use of NOA in Early Competition seems to be misaligned with both Ofgem and ESO thinking elsewhere.

With regard to defining the technical scope of a tender we also note that Ofgem state *“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.”* It remains uncertain therefore how the technical scope of a tender may actually be described, in suitable and sufficient detail, to enable bids to be developed and assessed on an equitable basis, and how this will interact with the ongoing NOA process, noting the multi-year timeframe to run the Early Competition process.

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?**

We are fundamentally opposed to the absence of a value threshold within the Early Competition criteria. As per SPEN’s response to both the Phase 2 and Phase 3 Early Competition Plan, and as set out in detail in our covering letter to this consultation, we believe the removal of the value threshold gives network operators little certainty as to what projects could potentially be eligible for delivery, via Early Competition models, making network planning and regulatory business planning essentially impossible. We disagree with Ofgem’s conclusion that an effective CBA can mitigate the need for a value threshold. TOs need certainty as to those projects they are expected to build under the RIIO framework, which form their Business Plan submissions to Ofgem. Such certainty is essential for investors to be able to meaningfully appraise potential investment into transmission infrastructure.

Removal of the ‘new’ and ‘separable’ criteria for Early Competition would, as with the removal of the high value criterion, cause further uncertainty in terms of network planning, future network development and operation and unnecessary complexity in the TOs’ (including those awarded CATO licences via competition) operations. Furthermore, removal of these criteria would be a significant departure from the regulatory regime. We question why Ofgem have proposed removing the new and separable criteria when the ESO state in its final ECP “that ‘new and separable’ are important criteria to ensure clear ownership arrangements”⁶ and that in their stakeholder engagement, no stakeholders objected to the new and separable criteria. As discussed in our covering letter, it seems to us that Ofgem have not fully thought through the true extent of what they are proposing.

6 Early Competition Plan, April 2021 (ESO) page 19

Our parent company, Iberdrola, invest significantly in UK networks every year. Iberdrola are proposing to spend in the region of £4.5bn between the Transmission and Distribution networks, based on the RIIO-2 Business Plans of projects we have submitted to Ofgem. Removal of the high value and ‘new’ and ‘separable’ criteria removes any certainty of what projects SPEN will deliver, and what projects will be subject to competition, making it impossible for SPEN to put forward an investment proposal to our key investor, in advance of every price control period. This is a significant departure from existing arrangements, and the UK regulatory framework in general, which Iberdrola has chosen to invest in. Such uncertainty and unpredictability would make it extremely difficult for prospective investors to properly appraise the prospect of investing under the RIIO framework at all, when virtually any project could be potentially subject to competition. Ofgem is already deploying uncertainty mechanisms for TOs to a much greater extent than has been previously seen for the RIIO-1 period. A persistent strategy of minimising predictability in the regulatory regime will damage investor confidence in the short and long term.

With a lower level of certainty around levels of investment, investors may view the regulatory regime as less favourable and as a result may increase their required return, ultimately resulting in higher prices. Indeed, one of the key criteria in Moody’s rating methodology for the regulated electric and gas networks industry is its ‘stability and predictability of regulatory regime’⁷.

Notwithstanding our above objections, we have yet to see any detail on the ESO’s proposed project specific CBA, which we believe is a critical piece missing from the proposed Early Competition model.

There are a number of practical and operational issues with introducing competition into projects which are not ‘new’ or ‘separable’ that would need to be factored into the project specific CBA produced by the ESO. For example:

- Operational risk would be greatly increased by having multiple parties operating assets;
- Staff from both parties would need to know and be trained in the other party’s health and safety rules and procedures;
- Both parties would need to have access arrangements for the other party in place; and
- There would be a need for duplication of a number of systems (e.g. SCADA and telecommunications systems, and black-start resilient control rooms).

The costs related to the above could be potentially significant and complex, depending on the projects that are subject to Early Competition and must be adequately accounted for in any project specific CBA to give a true account of any consumer value to be derived from delivering such projects via an Early Competition model. As mentioned above, such additional complexity could have negative impacts on the efficiency and economy of the future electricity system.

⁷ Moody’s (2009), “Rating Methodology. Regulated Electric and Gas Networks”, August, p.9.

SPEN's strong position remains that the new and separable criteria must remain in place, in order not to jeopardise effective network planning. These proposals will not promote efficiency and economy on the part of transmission licensees. This in turn could risk undermining the TOs' ability to secure ongoing compliance with their general duties under Section 9 of the 1989 Act to "*develop and maintain an efficient, co-ordinated and economical system*" of electricity transmission.

Our position is that TOs cannot be held liable for adverse events that are the fault of a third party. We have yet to see evidence of how Ofgem would equitably deal with liabilities resulting from failures on the network resulting from third parties under the current regulatory framework (for an example, an Energy Not Supplied (ENS) event experienced by one TO as a direct result of conditions on a CATO's plant and apparatus). The need to address this issue is fundamental to the implementation of Early Competition in any form, however the importance of this greatly increases, if any of the criteria, as detailed above, are removed.

In relation to the certainty of need criteria, we agree that it is required before a project is subject to Early Competition processes, so as not to embark upon a resource intensive and costly competitive process which has to be abandoned at a later stage, as the network need changes. Whilst we can understand why it could be thought that the inclusion in two of the ESO's Future Energy Scenarios (FES) scenarios provides sufficient confidence that a project would go ahead, such an approach is counter to the least worst regret methodology, which is central to the NOA process.

We would also offer caution in using the FES as providing a firm basis for determining strategic long-term infrastructure planning decisions. By way of example, the FES 2020, forecast a minimum transfer requirement across the B6 (the Scotland-England border) which was above the maximum transfer requirement forecast in the FES 2019, with this analysis only having been undertaken a year earlier. We question whether this would be acceptable to potential bidders who have, as per Ofgem's consultation, "*emphasised the importance of certainty around whether the project being bid for will remain needed and is able to progress to construction*".

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?

We recognise that the ESO already has some limited experience in procuring services via its role in operating the GB balancing market and Pathfinder projects. However, procuring such services from the market is very different to procuring the design and delivery of strategic network infrastructure. The scale and complexity of the projects to be funded through an Early Competition model are very different to the types and scale of investments that the ESO currently procures. Therefore, we agree with the ESO, in its Early Competition Plan that they will require substantial investment in financial, engineering, planning and design staff as well as additional IT and legal resources. It should be noted however, that such expertise particularly in engineering, planning and design already sits within the TOs and that these

proposals will lead to a duplication of skills and resources, sitting within the Procurement Body, which is not cost-effective for consumers to funds. Additional costs, such as these, should have been taken account of in Ofgem's Early Competition Impact Assessment, yet have not been.

We also note it would take significant time for the ESO to build this capability, with a consequential increase in project delivery risk as a result. As we have set out in our covering letter to this consultation, this could jeopardise the timely delivery of critical projects that essential to achieve GB's Net Zero objectives, notably the target to rollout an additional 30GW of offshore wind by 2030.

The Procurement Body must have the same statutory duties as a TO with respect to its licence obligation in relation to the *"development of an economic and efficient system"*. The actions or inactions by the Procurement Body could have a significant impact on the safe, secure and economic operation of the wider system and adjacent systems. We would expect this to be reflected and regulated through appropriate governance procedures. It is essential that the Procurement Body also has the relevant expertise in place to ensure security of supply.

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

We agree that there is a need for regulatory oversight of the Early Competition model and therefore, Ofgem should take on the role of the Approver and Licence Counterparty roles. As the energy regulator, it is essential that Ofgem has a strong say at each stage in the Early Competition process, whilst also maintaining full oversight role of the entire process. In overseeing the process, as per its regulatory duties, Ofgem must also have confidence that a competitive process will deliver benefits for consumers, when compared to the status quo RIIO regime.

The consultation says very little about the basis on which Ofgem will grant licences to any successful bidder in tender exercises. As we set out in our covering letter, such grant cannot be a *"fait accompli"* following the selection of the successful bidder by the ESO. It is essential that any new entrant meets appropriate criteria for the grant of any relevant licence and is appropriately regulated and supervised. This is Ofgem's responsibility, and, (as Ofgem will appreciate), cannot be delegated to the ESO.

The licensing framework for network activity has been carefully developed by Ofgem and its predecessors since vesting and privatisation. The consultation does not address Ofgem's role in respect of the regulation of the successful bidders. The thrust of the consultation is that such matters will be left to the ESO. A potential implication of Ofgem's proposals is that material elements of transmission and distribution activity may not be subject to licences and Ofgem supervision at all. Such an outcome would not be consistent with the 1989 Act.

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

We firmly believe that the network planning body role should remain with the TOs. As licensed owners and operators of transmission network assets, TOs already have the

expertise, resources and skills to develop projects, which are already subject to the rigour of the NOA process.

The removal of network planning responsibilities will not promote efficiency and economy in electricity networks. The proposals significantly risk undermining the TOs' general duties under Section 9 of the 1989 Act where it is the duty of each licence holder to "*develop and maintain an efficient, co-ordinated and economical system*" of electricity transmission. Therefore, the suggestion of giving network planning responsibilities to the ESO would risk significantly impacting TOs' ongoing ability to comply with their obligations to properly coordinate the system and ensure it operates efficiently and economically.

As we have explained in our covering letter, these proposals represent a fundamental change to network development and operation, and go far beyond any competition proposals made to date. They make almost all investment and expenditure in networks subject to potential competition. The existing framework, (developed carefully for over thirty years) is based on an entirely different model. If this new model is to be progressed all aspects of the regulatory framework will require to be reviewed to ensure that it is appropriate. As an example, the SO-TO Code and incentives such as Energy Not Supplied will need to be reviewed.

We do not believe the ESO is best placed to undertake increased network planning responsibilities, as this is not expertise which the ESO currently holds. Strengthening the network planning role of the ESO would require an increase to the ESO's skillsets to include, for example, project development and engineering design expertise. It will take time to build this capability and embarking on this process will likely introduce additional delays and complexities to the delivery of projects that are crucial to the UK's Net Zero ambitions. This will also result in duplication of resource that is already held within TOs, and we would question where this would add value to consumers. At a time where the industry is already suffering a skills shortage in these areas, we again would question where this would add value to the system or the consumer.

The ESO and Ofgem have failed to consider, and therefore undervalued, the extent of the community engagement and consenting activities in relation to network planning which TOs undertake, which is extremely important to secure positive outcomes for all parties. We have developed good, strong and enduring relationships with a wide range of local stakeholders, from local farmers to the Scottish Government, as part of our network planning responsibilities. Another party undertaking this role would risk damage to our existing relationships with these stakeholders and would add further complexity to the process. This could slow down the pace of projects, as the long-term relationships of trust built up by TOs would be swapped for more commercial, one-off relationships. We also believe that it would result in a duplication of resource, given that TOs will continue to undertake this work for projects out with the scope of Early Competition, with little benefit, if not detriment, to consumers.

Furthermore, if the network planning role was carried out by another party, then we believe that there could be efficiency losses. There are numerous occasions where we, using our network planning role, optimise our time working on a particular area. For example, if we plan

to build a new asset in an area, which also has ageing assets, we will carry out this work at the same time so as to limit the subsequent impact on the local community. This efficiency risks being lost if another party, unfamiliar with the local assets in question, was to carry out the network planning role.

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?

The purpose of Early Competition is, at least in part, a means to reduce costs for consumers, we cannot rationalise why the incumbent TO would not be able to develop the most cost-effective solution with reference to extensive existing learnings from RIIO.

If Early Competition was to be introduced in its current form as suggested by the ESO and Ofgem, subject to the primary legislation that is needed to introduce CATO licences, we would expect that once a party is awarded a CATO licence, then they would be subject to the same ringfencing arrangements as the incumbent TOs. We believe that this is a fundamental fact that has not been considered in the stakeholder engagement that has been undertaken by either the ESO or Ofgem to date.

As part of these arrangements, Ofgem question whether network feasibility assessments are necessary. If so, Ofgem question whether they should be carried out by the incumbent TO, or another party, which Ofgem suggests could be the ESO. We believe that it is absolutely necessary that a third-party bid has been assessed in terms of network feasibility by the incumbent TO. By not requiring that such assessment is carried out, Ofgem would seriously undermine the ability of TOs to secure compliance against their general duties under Section 9 of the 1989 Act to “*develop and maintain an efficient, co-ordinated and economical system*” of electricity transmission. Noting the wide range and complexity of equipment types in service on the transmission system, including HVDC systems and series compensation. For example, there could be potential risks to security of supply and public safety, should something go wrong. Our position is that TOs cannot be held liable for adverse events that are the fault of a third party in these circumstances. The suggestion that Early Competition projects may not have to be ‘new’ or ‘separable’ complicates these matters further.

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

We believe that there has not been the same level of effort, or desire, to explore a suitable model to allow the incumbent TO to participate in Early Competition as a counterfactual. We note that the ESO in their final plan to Ofgem suggest that “*there are several key areas which require significantly more thinking to develop a counterfactual model which maintains a level playing field between the incumbent TO and other bidders*”⁸. In the Early Competition Plan, the ESO also state that the ESO Networks Stakeholder Group (ENSG) felt the ESO could have explored the counterfactual approach with stakeholders more. Instead, Ofgem appears to have dismissed this proposed approach with limited consideration. We think it is highly inappropriate for Ofgem to discount the TO counterfactual approach at this point in the

⁸ [ESO Early Competition Plan- April 2021](#)

process. Ofgem should look to work with stakeholders to create a model that allows TOs to compete fairly within the regulatory framework, whilst being palatable to all stakeholders.

We understand from the ESO that there may be difficulties to establishing a regime where the TO acts as a counterfactual that allows for a regulated option (the counterfactual proposal) to be compared against a competitive option (the market-led proposal). However, given that there has not been an effort to explore this model, we do not think Ofgem have sufficiently evidenced their decision not to continue to work on this option for Early Competition.

SPEN's preferred option continues to be for the incumbent TO to participate in Early Competitions as the counterfactual, through the RIIO framework. Having the TO compete as a counterfactual, by comparing the TO solution to market bids, ensures that consumers do not miss out on the value for money that the RIIO model has been designed to ensure. It will allow for the TOs to operate in the regulatory framework that they have been designed for and allow consumers to benefit from the advantages of this model that they have already paid for. For example, whole system knowledge and thinking and expertise in network planning and delivery. As per our response to Chapter 3: Question 1, we believe that Ofgem have built the RIIO regime with the intention to be a strong regulatory model which incentivises companies to be innovative and efficient in their costs. Further, the TO is obliged and well placed to consider longer-term factors in relation to developing the network and importantly, it understands the risks of certain unproven proposals to security of supply, which might not be appreciated by new market participants.

Adopting the counterfactual approach will insure against a situation where a market bid is unable to deliver. If the TO is not a counterfactual and the chosen market bid fails to deliver, this would undoubtedly lead to consumer detriment in terms of delays, leading to constraint costs being higher than necessary.

We fear that Ofgem choosing to abandon the regulatory model without a sufficient attempt to develop a counterfactual model is not in the consumers best interest. We also believe that it will be difficult for Ofgem to prove the monetary benefits of early competition to consumers without comparison to a regulated TO bid.

Chapter 6: Tender process and commercial model

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

There is clearly a significant volume of work required to develop a commercial framework. The consultation notes that this is still in development, and whilst some key mechanics of the model have been published, we note that this is still a more complicated model than what we believe those market participants will be used to.

The bid process may be perceived by the market to be overly complicated and introduce different types of risk that these organisations are structured to absorb and deal with. It may

be that the risk of (high) abortive cost based on the model requirements may act as a barrier to entry and risk diminution of potential solution partners.

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

A key part of project development is environmental assessment, planning and consenting, which commences at an early stage of the project development process by the incumbent TOs. Significant infrastructure requires detailed and often complex consenting processes usually requiring early surveys and other assessments. Without this early engagement and level of assessment, projects attract significant time and cost risk. For example, a number of assumptions would need to be made about routing, costs and siting. As per the current model, preliminary works are only carried out after a licence is awarded, and it is at this point where the detailed assessments and consenting would take place.

As already noted in this response and in our covering letter, based on the ESO's Early Competition model as submitted to Ofgem in April 2021, we believe that Early Competition already adds an additional 2.5-3 years⁹ onto the delivery of projects to allow time for the bidding process to take place. This represents 'lost time' in the programme that could be utilised for planning, consenting and engineering of the projects, not only reducing the programme timeline but mitigating risk. Adding additional inertia into the process would inevitable risk impacting the timely delivery of projects which are crucial contributors to the UK's Net Zero objectives.

⁹ [ESO Early Competition Plan- April 2021](#)