

By email:
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Date
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Contact / Extension
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Dear colleague

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

This response is from SP Energy Networks (SPEN). SPEN owns and operates the electricity distribution networks in the Central Belt and South of Scotland (SP Distribution plc) which serves two million customers, and North Wales, Merseyside, Cheshire and North Shropshire (SP Manweb plc) which serves one and a half million customers. We also own and maintain the electricity transmission network in Central and South Scotland (SP Transmission plc). Section 9 of the Electricity Act 1989 (EA '89) and the terms of SPEN's transmission and distribution licence obligations require us to develop and maintain an efficient, coordinated and economical, onshore electricity system. We already support a significant amount of competition on our network, with c. 96% of our regulated transmission activities being delivered by the market¹.

We were actively involved in the development of the Early Competition Plan (ECP) with the ESO. We therefore welcome the opportunity to respond to Ofgem's consultation on their views of Early Competition. In general, and as we have previously stated in our responses dated 14 August 2020 and 15 February 2021 to the ESO's ECP Phase 2 and Phase 3 consultations, we have fundamental concerns with these proposals for Early Competition. The proposals set out by Ofgem in this latest consultation gives us cause for even more concern.

In particular, Ofgem's proposal to remove the high value threshold, and the 'new' and 'separable' criteria is a fundamental shift in the RIIO framework which would potentially subject almost any expenditure on the transmission network to competition.

These proposals go far beyond any of the preceding Ofgem competition in networks proposals. If implemented, they would represent a very material change to the current regulatory arrangements governing electricity networks. Those arrangements have been built up, over thirty years, under the supervision of Ofgem and its predecessors.

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

This introduces very significant uncertainty around the parameters for our RIIO-T3 planning, which is already underway. What is to be delivered and by whom will be entirely uncertain. It will be extremely difficult to estimate with any level of certainty what might be in the baseline proposals for T3. This level of uncertainty and unpredictability will risk creating significant issues around our ability to attract the required investment.

The proposals will also introduce significant additional complexity into the way the main transmission and distribution systems will be developed, operated and maintained. There will be potentially many additional entities involved in networks activity. This is not envisaged under the current, carefully developed regulatory framework. This naturally introduces significant additional complexity and risk to system operability. It appears to us that Ofgem has not properly considered its statutory duties under the EA '89 as the proposals raise very serious questions around potential impact on present and future consumers, security of supply, safety, and the continued provision of an efficient, co-ordinated and economical electricity network.

The introduction of these new processes and policies, with the potential knock-on delays that could impact the development of infrastructure projects, also puts at risk the timely delivery of critical projects required to achieve Net Zero – for example, the UK Government's offshore wind targets of 40GW capacity by 2030. SPEN has material reservations as to whether these radical proposals are in the interests of present and future consumers. They seem likely to lead to material delays in the delivery of essential transmission infrastructure, particularly as the ESO's Early Competition Plan² proposed a timeline of 2.5-3 years to appoint a preferred bidder.

Ofgem's proposals involve a fundamental change to the planning, development and operation of electricity networks which will potentially significant impact on TOs' future ability to develop and maintain an economic, efficient and coordinated network across GB and therefore the ability of licensees to make their contribution to the delivery of Net Zero. If these proposals are introduced, the full suite of obligations and incentives imposed on network licensees will require to be reviewed. Upon reviewing this consultation and associated draft Impact Assessment, it is not clear to us whether Ofgem has grasped the very significant consequences of the changes that are being proposed to both investors and customers.

² Early Competition Plan (ESO) p 62, <https://www.nationalgrideso.com/document/191251/download>

These concerns are detailed throughout the Annex to this letter, which contains SPEN's responses to the questions posed by Ofgem in their consultation. In addition, we wish to offer the following comments under the following headings:

1. Impact on TOs' licence obligations to develop and maintain an efficient, co-ordinated and economical system
2. Ofgem's role
3. Achieving Net Zero
4. Delivering consumer value
5. The removal of the high value threshold and 'new' and 'separable' criteria for projects to be delivered via Early Competition models
6. TOs acting as the counterfactual in Early Competition
7. Ofgem's Impact Assessment

1. Impact on TOs' licence obligations to develop and maintain an efficient, co-ordinated and economical system

Ofgem's consultation is proposing an enhanced role for the ESO in challenging the TOs' network solutions, which will transfer certain network planning responsibilities from TOs to the ESO as well as giving additional powers to the ESO to encourage and promote third party transmission network solutions. Again, these proposals could risk TOs' ability to comply with their licence obligations, for example Standard Licence Conditions B12, and makes it far more difficult for TOs to properly co-ordinate the system and ensure its economic and efficient development, operation and maintenance.

Careful consideration is needed of the potential impact of the TOs' and ESO's obligations under the System Operator Transmission Owner Code (STC) and other relevant documents. For example, the TOs have responsibility to "*plan, develop, operate and maintain its Transmission System*".³ The ESO's proposals risk adversely impacting the TOs' ability to, amongst other things, plan and develop their own transmission systems. This in turn raises serious questions around TOs' (and the ESO's) ability to secure the ongoing compliance with their obligations under the STC, a requirement of Standard Licence Condition B12.

The narrow focus we have observed to date on the potential impacts of Early Competition on TOs' compliance with licence, statute and industry codes is disappointing and fails to recognise the long-term and wider implications of the proposed changes on future system operation.

³ S2.2 STC

2. Ofgem's role

The EA '89 provides for a regulator, (Ofgem), which has critical duties and responsibilities in respect of the regulation of the electricity industry. The system of licences is one of the most critical “building blocks” of the regime. The consultation says very little about the basis on which Ofgem will grant licences to any successful bidder in tender exercises. Such grant cannot simply follow automatically after 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 ESO⁴.

The licensing framework for network activity has been carefully developed by Ofgem and its predecessors since vesting and privatisation. The consultation does not deal with 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 robust Ofgem supervision. Such an outcome would not be consistent with the EA '89 and the intention of Parliament.

3. Achieving Net Zero: 2.5 to 3 Year Delays to Appoint a Preferred Bidder

Ofgem will be mindful of its principal objective to protect the interests of existing and future consumers, including (amongst other things) their interests in the reduction of greenhouse gases. In formulating its proposals on Early Competition, we strongly question the extent to which Ofgem has thoroughly considered its principal objective in assessing its Early Competition proposals to ensure they will help to facilitate the delivery of Net Zero on time and at the best value for existing and future consumers.

The ESO's Early Competition model that was submitted to Ofgem suggests that it could take approximately 2.5 to 3 years⁵ from the NOA assessment stage to select a preferred bidder. Further delays to project delivery seem inevitable due to the technical and commercial complexity of tendering and awarding/negotiating contracts/licences, in addition to the lengthy timescales associated with the bringing into effect of necessary legislative change, which will be essential to bring Ofgem's proposals into effect. Such lengthy timescales 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.

Network infrastructure is critical to the timely delivery of Net Zero. We question whether the implementation of a model which involves delay and new entrants delivering network infrastructure is the right solution, given the unprecedented amount of network infrastructure required to be

⁴ Note in this regard comments in *Competition in Onshore Electricity Networks*, BEIS, August 2021, Page 13.

⁵ Early Competition Plan (ESO) p 62, <https://www.nationalgrideso.com/document/191251/download>

delivered to achieve the Net Zero targets legislated for by the UK and Scottish Parliaments, and the need to deliver an additional 40GW of offshore wind by 2030.

The ESO's annual Network Options Assessment (NOA) outcomes show the scale and cost of the transmission infrastructure that is required to facilitate the Net Zero transition. For example, NOA6 (2020/21) has indicated the need for four Eastern HVDC Links from Scotland to England. Overall, schemes recommended to 'Proceed' by NOA6 result in a total investment cost in the SPT area of £2.34bn⁶ over the next 13 years, an increase of £1.29bn from last year's NOA5 forecast. Using these NOA outcomes as precedent, the need for large transmission infrastructure is increasing and we are not confident that the current Early Competition model proposed by the ESO will be able to deliver the scale of infrastructure required on the timely basis needed.

We also question how this work aligns with the ongoing BEIS/Ofgem Offshore Transmission Network Review and whether the introduction of Early Competition models to the delivery of offshore transmission infrastructure will further complicate, already complex proposals, increasing the risk of costs and delays to both offshore generators and consumers. Again, further complexity introduces further risk to the achievement of the UK Government's 40GW offshore wind target.

4. Delivering consumer value

Despite the lengthy process that has been undertaken to develop the Early Competition framework, neither Ofgem, nor the ESO, have proven that there is consumer benefit in implementing this framework. 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, which are 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 is likely to lead to piecemeal solutions to individual network needs. This approach is difficult to reconcile with current thinking in other areas of Ofgem policy work. No proposal should be progressed unless a clear consumer benefit can be demonstrated with a relevant and detailed Impact Assessment. We are concerned that the current proposals will result in sub-optimal outcomes for consumers in the longer term, in order to achieve a goal of introducing competition for the sake of competition.

5. The removal of the high value threshold and 'new' and 'separable' criteria for projects to be delivered via Early Competition models

The proposal to have no value threshold on projects that could potentially be subject to delivery via an Early Competition model, and removal of the 'new' and 'separable' criteria for projects makes network and business planning for TOs very challenging. The result, as we understand it, is that potentially any investment could be subject to competition. This uncertainty and unpredictability

⁶ Assumes SPT delivers 50% of HVDC works in both HVDC links

makes it incredibly challenging for TOs to plan for RIIO-T3. The result is complete uncertainty as to which entity actually develops and delivers the required investment in transmission systems. This calls into question how a meaningful baseline investment plan can be produced.

Ofgem identified the £100m threshold as a key criterion for projects potentially eligible for Late Competition. This threshold was calculated as the point at which consumers will continue to benefit from projects delivered via Late Competition models i.e. where the additional costs for tendering etc. are outweighed by additional consumer benefits. We note that BEIS is consulting on late competition reforms with criteria of new and separable, and that BEIS still anticipates the use of a high value threshold under those proposals.⁷

The proposal to have no value threshold is a significant departure from existing processes and assessments. Furthermore, it remains the case that for both the RIIO-T2 and RIIO-ED2 frameworks, Ofgem is suggesting that there should be a minimum value threshold of £50m for Early Competition models, although further consultation will be undertaken. We question how Ofgem can be confident that consumer benefits can be derived from the delivery of projects, via Early Competition models, regardless of the value of the project in question, particularly as no CBA has been developed which Ofgem have said will incorporate additional costs associated with different values of projects.

Furthermore, we believe the suggestions of the removal of the ‘new’ and ‘separable’ criteria from Early Competition also creates extensive challenges that have not been considered by Ofgem, nor the ESO. For example, there are a multitude of practical issues that need to be properly explored:

- Operational risk would be greatly increased by having multiple parties developing and operating assets – a risk which would continue to increase over time as the system becomes ever more complex;
- Staff from the incumbent TO and new entrant 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 inclusion of a clear value threshold and the ‘new’ and ‘separable’ criteria as part of the Early Competition criteria is critical. The uncertainty as to which of a network operator’s future network projects will potentially be subject to an Early Competition model will undoubtedly affect investors’ trust and confidence in GB networks as being stable, predictable regulated entities. This will in turn affect investor appetite to invest in GB network infrastructure and potentially increase the cost of capital, at a time when unprecedented investment is needed to facilitate the UK, Scottish and Welsh Governments’ Net Zero ambitions.

⁷ Competition in Onshore Electricity Networks, BEIS, August 2021, Page 28.

Our parent company, Iberdrola, invests significantly in UK networks every year. Iberdrola are proposing to spend in the region of £4.5bn between the UK Transmission and Distribution networks, based on the business plan of projects we put forward to Ofgem as part of the RIIO-2 settlement. 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, and is a significant departure from existing processes and assessments, and the UK regulatory framework in general. 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.

Further, the implementation of an Early Competition may affect investors’ and rating agencies’ perception of regulatory stability and predictability in the regulatory regime. 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’⁸.

6. TOs acting as the counterfactual in Early Competition

As detailed in our Phase 2 Consultation Response, TOs participating as market players takes us outside the realm of the regulatory framework within which we are designed to operate. With the potential for Early Competition winners to be subject to different licence provisions, compared to those of the incumbent TOs, these proposals have the potential to dilute the strength of the existing licence obligations which underpin the effective operation and maintenance of the resilient GB-wide network. This regulatory framework has been developed iteratively over an extensive period of time to ensure energy security, affordability and that the reduction of carbon and greenhouse gas emissions is achieved. Given what is at stake – a secure and stable electricity network for GB consumers – such a significant departure from the existing framework must be carefully thought through so as to ensure no detriment to the service that consumers receive.

We have continually reiterated our position that the incumbent TO should be treated as the counterfactual position, against which market bids are measured – this is the logical counterfactual. This is not least due to our unrivalled expertise and experience in delivering network developments, but also due to our obligations under the RIIO framework to be as efficient as possible, in how we operate. Only then can Ofgem be truly confident that a market-led proposal delivers greater consumer benefit compared to the existing arrangements under the RIIO framework.

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

⁸ Moody’s (2009), “Rating Methodology. Regulated Electric and Gas Networks”, August, p.9.

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”*⁹. They also note 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 process. Ofgem should look to work with stakeholders to create a model that allows TOs to compete fairly under Ofgem’s regulatory framework, whilst being palatable to all stakeholders.

7. Ofgem’s Impact Assessment

We welcome Ofgem’s publication of a draft Impact Assessment on whether to continue the development of the Early Competition policy, alongside this consultation, (which we have been calling for since the inception of Early Competition). However, we are extremely concerned at the lack of detail and evidence in the Impact Assessment, for Ofgem to conclude that Early Competition is likely to be in the best interest of consumers. Given the potential impacts these proposals could have on future system operation and consumer value, we expect Ofgem to undertake a further, significantly more detailed Impact Assessment as it develops the policy.

Our detailed concerns on Ofgem’s approach to their Impact Assessment can be found in the enclosed annex to this letter, under Chapter 3, Question 1. However, our key concerns include the following:

1. **Quantitative Benefits Case:** Ofgem have based the quantitative benefits case for Early Competition largely on just two projects, both in North America. The regulatory regime for networks in North America is very different to that of the UK’s incentives-based economic regulation. Ofgem does not seem to have properly accounted for such differences in its assessment. Furthermore, basing estimates of potential savings on only two projects is not, in any view, robust evidence.
2. **Qualitative Benefits Case:** Ofgem quote a number of theoretical, benefits in their Impact Assessment for Early Competition. For example, Ofgem said that Early Competition *“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”*. Ofgem have not offered sufficient evidence to support such claims.
3. **Costs of Early Competition:** The one-off development costs and costs of running a tender used by Ofgem are based on estimates from the ESO in their Early Competition Plan. The ESO themselves state that these estimates require further work to substantiate them. This work was not done by Ofgem prior to using them in the Impact Assessment. Ofgem should therefore undertake this further work and then undertake the Impact Assessment afresh.

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

- 4. Cost Benefit Analysis (CBA):** Ofgem have highlighted a number of areas representing risk, and therefore cost, that they have not included in their Impact Assessment. Examples include: (i) risks relating to security of supply, due to the increased number of entities involved in system development, operation and maintenance; and (ii) costs associated with late delivery of projects as a result of the potentially lengthy processes introduced by the Early Competition proposals. These costs include monetary costs and the additional greenhouse gas emissions. 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. Without sight of this CBA methodology, it is impossible to evaluate the consumer benefit of running an Early Competition for different transmission assets. This is heightened as Ofgem are considering removing the high value threshold and the 'new' and separable' criteria.

It continues to be SPT's view that introducing lengthy delays into the delivery of significant infrastructure required to attain Net Zero is to the detriment of consumers and generators alike. The material constraint costs that the ESO are forecasting, if key strategic transmission network infrastructure is delayed, is a highly relevant factor. For example, analysis in 2019 showed a one-year delay on the first Eastern Link would cost GB consumers an average of £330m in constraint costs.¹⁰ Further, delays to network infrastructure result in higher carbon emissions, for example because new wind generation cannot run. Such outcomes are not in the interests of present and future consumers and must be considered.

The implementation of an Early Competition model, driven by theoretical analysis, will likely compromise genuine consumer value and the timely delivery of critical projects for Net Zero. This would undermine the regulatory framework which is designed to ensure consumers are afforded best value and protect the interests of existing and future consumers.

Finally, SPT's position is that primary legislation is required to implement the proposed reforms.

Please find our detailed response to each of the consultation questions in the enclosed Annex.

Yours sincerely



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¹⁰ <https://www.nationalgrideso.com/document/137321/download>