Decision

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Decision on the development of early competition in onshore electricity transmission networks

Subject	Details
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This document provides our updated views on development of early competition in onshore electricity transmission networks. In particular, it summarises our decisions on the specific points we sought views from respondents in our August 2021 consultation.

Contents

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. It encourages additional innovation in the design, delivery and operation of transmission infrastructure. This should help ensure that solutions can be delivered quicker and at lower cost. In our August consultation we summarised our initial views on the Electricity System Operator's (**ESO's**)[1] Early Competition Plan (**ECP**)[2].

This document summarises the responses we received to our August consultation[3], along with our latest views and decisions on development of early competition, having carefully considered each of these stakeholder responses.

What this decision document covers

Our August consultation recognised that certain details in the ECP could not be fully developed until the key roles and responsibilities within early competition had been identified and allocated. For this reason, our consultation questions focussed 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 projects[4] are most likely to deliver benefits for consumers through the application of early competition.

[1] National Grid ESO
[2] Early Competition Plan Project | National Grid ESO
[3] Consultation on our views on early competition in onshore electricity transmission networks | Ofgem For the purposes of this document when we refer to "our August consultation" we are referring to this consultation on early competition in onshore electricity transmission networks.
[4] 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

This document confirms that we have determined that it is in consumer interest for the ESO to complete its development of an early competition model that can be applied to the electricity transmission sector. This document also outlines our views on the following key points from our August consultation:

- 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 key roles that would be played within early competition and the parties best placed to play those roles.
- The high-level tender policy and process arrangements and the commercial model applied to successful bidders.

Summary of our decisions on early competition

We still consider (as supported by our updated Impact Assessment) that the continued development of the arrangements to allow early competition in electricity transmission represents good value for money for consumers. This is because it is relatively low regret, whilst we expect that the potential savings and other benefits (for example in terms of innovation) over the longer-term will be significant. We also consider that early competition, has an important role to play in future network planning and could be an important tool through which the ESO, and the proposed Future System Operator (**FSO**)[5] could deliver benefits to consumers.

We consider that the tender process and commercial model available to successful bidders proposed in the ECP are reasonable overall. We expect the final design of these to appropriately reflect the concerns raised by respondents to our consultation. In this decision we agree with the ESO's proposals for assignment of roles and responsibilities. We do agree that Ofgem should be the Approver but disagree that this role should include the confirming of the Procurement Body's Preferred Bidder following the tender process. We have concluded that the ESO is the most appropriate body to undertake the Procurement Body role. With this in mind, we consider it would be appropriate for the ESO, as the Procurement Body, to determine the successful bidder following the tender process.

[5] Proposals for a Future System Operator role | BEIS

The process proposed by the ESO for identifying network needs that are suitable for early competition was developed based on the existing network planning process under the Network Options Assessment (**NOA**)[6].

Since our August consultation, the initial findings from our Electricity Transmission Network Planning Review (**ETNPR**)[7] have proposed that the annual NOA process should be superseded by the development of a Central Strategic Network Plan (**CSNP**) process that is run every 2-3 years. The decisions we have reached on the criteria for identifying network needs are compatible with both the existing NOA process and the initial findings of the ETNPR. We consider that the criteria for early competition identified in this decision will allow for projects to be identified at a suitably early stage to ensure that the early competition process does not lead to delays in comparison to the counterfactual of monopoly TO delivery.

Next steps

This decision confirms that the ESO should continue to develop the early model of competition. We expect the ESO to develop a model that will be compatible with the decisions in this document. It should also be developed in line with the findings of the ETNPR.

Legislative change is required to underpin the full early competition model proposed in the ESO's ECP. The government has set out its intention to introduce the required legislation[8], and BEIS is working closely with us and industry to develop this policy to ready themselves to legislate when Parliamentary time allows.

In terms of the detailed development of the commercial model and the tender process, we consider that this is best progressed by the Procurement Body within the early competition model. Our decision is that the ESO should prepare to undertake this role before it transitions to become the FSO, if the decision is made to implement the FSO.

[6] https://www.nationalgrideso.com/research-publications/network-options-assessment-noa
[7] https://www.ofgem.gov.uk/publications/consultation-initial-findings-our-electricity-transmission-network-planning-review
[8] 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

1. Introduction

Context and related publications

1.1. This document summarises our views on early competition, including the ESO's ECP findings. Published alongside it is an updated Impact Assessment (IA). This IA 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.

Chapter 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.

Chapter 3: ESO's Early Competition Plan

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

Chapter 4: Identifying which needs are suitable for early competition

1.4. Chapter 4 explains how projects would be identified as suitable for early competition and our decision on how the criteria for early competition should be calibrated.

Chapter 5: Roles and responsibilities within Early Competition

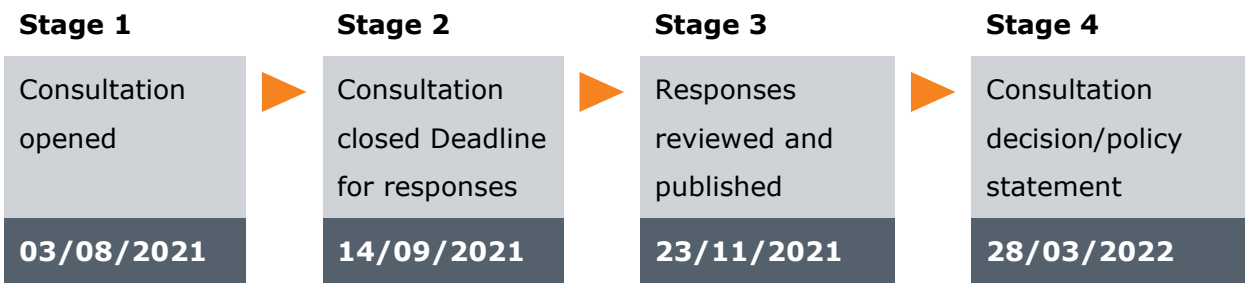
1.5. Chapter 5 provides a summary of the roles and responsibilities required to facilitate early model competition.

Chapter 6: Tender process and commercial model

1.6. Chapter 6 summarises stakeholder feedback on the tender process and commercial model proposed by the ESO in its ECP and our view on how these considerations should be taken forward as part of the development of the model.

Our decision-making process

Figure 1: Decision-making stages



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.

This decision

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**)[9], we requested that the 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 Determinations[10] 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 ECP[11]. In August we consulted on our views on early competition, including the ECP's findings.

2.4. This document sets out our decision on the aspects that were consulted on in our August consultation. It includes our consideration of consultation responses as well as other updates from related projects, such as the ETNPR that have been considered since the publication of the consultation document.

[9] https://www.ofgem.gov.uk/publications/riio-2-sector-specific-methodology-decision
[10] https://www.ofgem.gov.uk/sites/default/files/docs/2021/02/final_determinations_-_core_document_revised.pdf
[11] Further information is available here, ESO final Early Competition Plan, April 2021: https://www.nationalgrideso.com/document/191251/download

What is early competition?

2.5. Early competition refers to a competitive tender that takes place ahead of detailed design work for the preferred solution. In the context of this decision, 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 build 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.

How has early competition developed in the electricity transmission sector?

2.6. As Great Britain (**GB**) 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. This is achieved 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**). This drives innovation in the design and delivery of electricity transmission meaning projects can be delivered cheaper and quicker.

2.7. The government has set out its intention to introduce new legislation[12], when Parliamentary time allows, to enable competitive tendering for building, owning, and operating onshore electricity network assets. In August 2021 Government published a consultation on competition in onshore electricity networks which provided an update on this policy, including early competition, as well as seeking stakeholder views on implementation of the legislative framework for competition[13].

2.8. 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

[12] Page 77, Energy White Paper (publishing.service.gov.uk) (Powering our Net Zero Future, December 2020)
[13] https://www.gov.uk/government/consultations/competition-in-onshore-electricity-networks

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. Given the similarities between certain aspects of the pathfinders and its ECP proposals, the ESO intends to continue to develop and improve pathfinders alongside the continued development of its ECP proposals.

Electricity transmission network planning and its interaction with early competition

2.9. The annual 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**)[14] 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 options[15], 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.

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

2.11. In addition, the ESO has introduced what is known as the "Interested Persons Options 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.

[14] Future Energy Scenarios | National Grid ESO
[15] 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

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

2.13. The network planning processes in general, including the NOA process, are critical in ensuring that necessary investment is delivered to allow GB to reach its Net Zero targets. For this reason, we are carrying out a strategic review of electricity transmission network planning, referred to as the ETNPR. In November 2021, we consulted on our initial findings from the ETNPR.

2.14. Our August consultation emphasised the importance of any development of an early competition model fully considering the appropriate interaction with network planning processes. With this in mind, Chapter 4 of this document references where the ETNPR initial findings have had an impact on our decisions relating to the identification of which projects may be suitable for early competition.

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

2.15. 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 consulted on proposals for an expert, impartial FSO with responsibilities across both the electricity and gas systems, including all the current roles and functions of the ESO.

2.16. It is critical that any development of an early competition model is compatible with the ESO's existing responsibilities, whilst also considering potential changes to the electricity system operation responsibilities as part of the FSO project proposals. 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.

2.17. We consider that all the arrangements summarised, and positions set out in this decision remain compatible with the proposals set out for an FSO. This is subject to decisions made on the FSO, and associated timings, which will be set out in the upcoming FSO consultation response.

Interaction with late competition

2.18. We remain committed to the development of late competition as part of the RIIO price control arrangements. 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). We consider that late competition can drive significant consumer benefits for these projects.

2.19. The late competition arrangements are outside of the scope of this decision 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 2016[16] 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 specific aspects of the arrangements for tender process or commercial model for successful bidders.

Interaction with Offshore Transmission Network Review (OTNR)

2.20. 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 established OTNR, a BEIS-led cross-industry project in which we provide leadership on specific areas.

2.21. Last year we published our consultation on changes intended to bring about greater coordination in the development of offshore energy networks[17]. 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. That consultation is clear that delivery models for onshore infrastructure are not within scope and that different models could apply onshore and offshore. We have since issued an update on our direction

[16] https://www.ofgem.gov.uk/publications/extending-competition-electricity-transmission-decision-criteria-pre-tender-and-conflict-mitigation-arrangements

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

of travel across all four areas of the OTNR workstream.[18] We expect to publish a decision on delivery models for the Pathway to 2030 workstream later this spring. This will be followed by a BEIS publication in the summer on the Enduring Regime workstream, which focuses on the longer-term goals of offshore coordination beyond 2030.

2.22. Although the relevant time constraints may limit the range of feasible options available for the Pathway to 2030 workstream, our intention is to align our approach to competitive regimes and associated arrangements across the onshore and offshore sectors as much as possible. This is beneficial in ensuring that a competitive market of bidders across onshore and offshore infrastructure can develop to drive savings for consumers through clear and easy to understand arrangements.

2.23. We consider that an equivalent early model of competition can deliver consumer benefits offshore. However, it is important that the longer-term arrangements for offshore co-ordination fully consider the specific technical requirements of the offshore sector and the extent to which there is sufficient scope for innovation (e.g. multi-terminal offshore connections) while not preventing point-to-point connections where the central network planner puts forward a radial solution.

[18] Update following our consultation on changes intended to bring about greater coordination in the development of offshore energy networks | Ofgem

3. ESO's Early Competition Plan

Section summary

This Chapter explains the ESO's Early Competition Plan and confirms our decision that the ESO should finish developing a model of early competition for application to the electricity transmission sector.

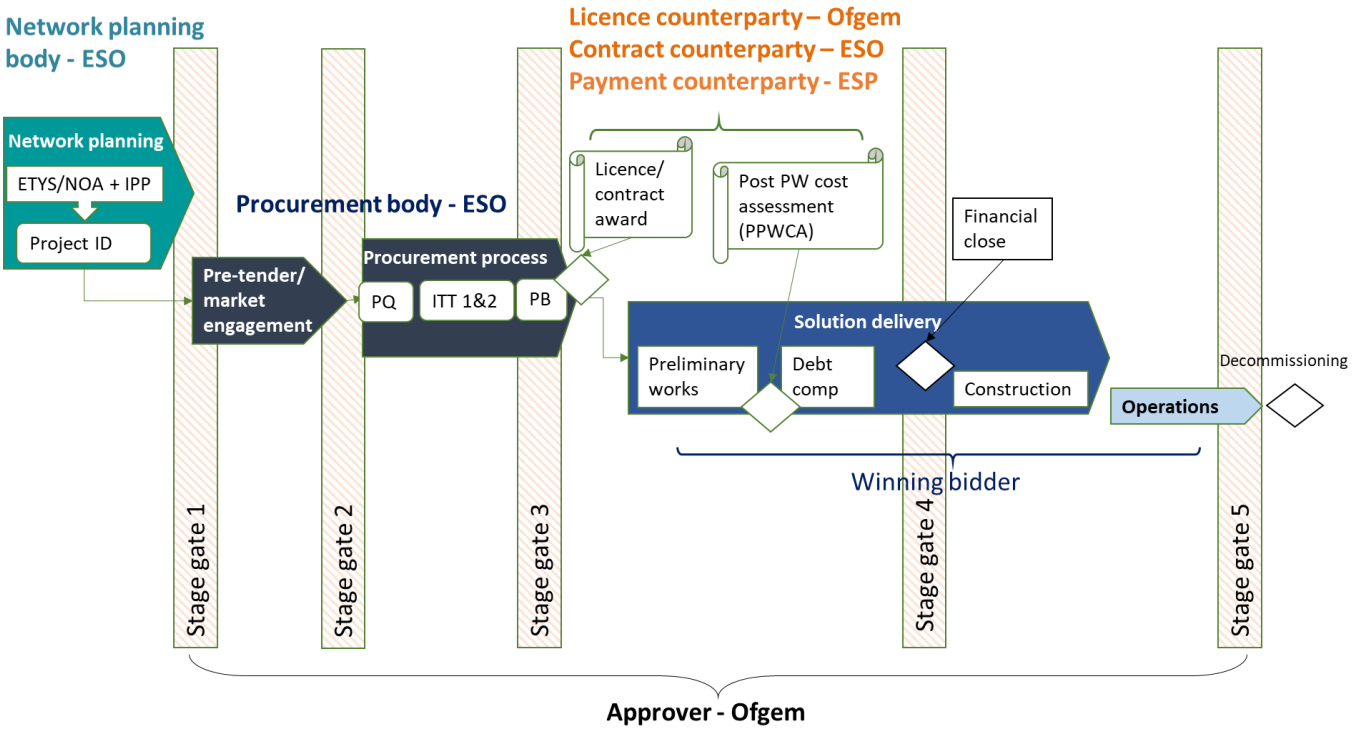
3.1. The Early Competition Plan (**ECP**) was published by the ESO in April 2021. It sets out the ESO's view on how an early competition tender process could work, and how it could be incorporated into the electricity transmission network planning process. The ESO's proposals for early competition, once the necessary legislation is in place, will allow for a full range of network and non-network solutions to participate in such competitions.

3.2. The ECP included 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.

3.3. 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
IPP	Interested Persons Process
PQ	Pre-Qualification
ITT	Invitation To Tender
PB	Preferred Bidder
PPWCA	Post Preliminary Works Cost Assessment

Summary of our consultation

3.4. Our consultation focused on the 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 was because these aspects are central to enable the timely development of the rest of the early competition framework. It is on only these aspects that we have made a decision, as set out in this publication.

3.5. Our consultation explained that 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 Body[19] responsibilities have been allocated. For this reason, our consultation only provided our initial views on the tender process and commercial model.

Summary of responses to our consultation

3.6. In total we received 10 responses to our consultation. One of these was a confidential response that has not been published on our website. The responses came from a range of stakeholders; including potential bidders, incumbent transmission owners, Scottish Government and the ESO.

3.7. Aside from two of the three existing monopoly Transmission Owners (TOs), the majority of respondents were supportive of the principle of continuing the development of an early model of competition. Despite this general support, respondents raised a range of points that they felt should be clarified or considered in more detail as the model is further developed. Within Chapters 4 and 5 we summarise how we have considered these views in reaching the decisions set out in those Chapters. In Chapter 6 we explain how these considerations will feed into the ongoing development of the model.

3.8. In terms of the TOs that opposed our consultation position, this was based on the criticism of the IA. In their view it did not sufficiently capture the low cost of capital of the counterfactual set under the RIIO-2 price control. They also considered that potential negative impacts of early competition on delivering our Net Zero targets and maintaining security of supply were not appropriately considered. One TO was of the opinion that it was inappropriate to progress the development of an early model until evidence is presented that the model meets the following tests of consumer interest and benefit:

1. Accelerates rather than delays the delivery of Net Zero targets
2. Maintains security of supply

[19] 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. Delivers benefits to consumers on a lifetime cost basis.

Summary of our consideration of these views

3.9. We do not consider that an existing monopoly TO is the appropriate party to propose the tests that need to be met to be sure that a model of competition will deliver benefits to consumers relative to the continuation of TO monopoly delivery. However, we do consider that the three tests proposed by the TO would represent a reasonable means of testing whether early model competition is likely to be worth pursuing for a specific project. Furthermore, we consider that there is, in fact, compelling evidence that the continued development of the early competition model can indeed deliver against all of these proposed tests.

3.10. As was clearly explained in our consultation and associated IA, we consider that there will be limited projects where introducing competition is likely to lead to delays. As explained in this decision[20], the criteria for early competition will allow for projects that are needed but don't yet need to proceed straight away to be considered for early competition. This will allow viable projects to be considered for early competition at a sufficiently early stage and proceed to an early competition tender, well ahead of when the TO would otherwise seek planning approval or start its own tender process, to avoid delays. Irrespective, our analysis clearly indicates that very few projects would need to deliver savings through early competition in order for us to be sure that the savings for consumers will offset the costs associated with finalising the model. There is no evidence, provided by the TOs, or otherwise, that the volume of projects suitable for early competition, would be so low as to not be likely to result in overall benefit to consumers relative to the costs associated with finalising the model. Furthermore, we consider that early competition will drive additional innovation, including through non-network solutions, which can actually speed up the delivery of necessary investment to meet our Net Zero targets.

3.11. We acknowledge that there may be particular network investments that may not be suitable to be delivered through early competition. This is something that would be considered through the project-specific early competition cost benefit analysis (**Competition CBA**) in which any cost of potential delay would be a key consideration.

[20] See paragraphs 4.42 to 4.46

3.12. Bidders in the competitions will be required to deliver against the technical specifications determined through the network planning process based on a reference design. Solutions will need to be compliant with all associated industry standards, and bidders will need to demonstrate that they meet the required financial and technical requirements included in the bid assessment process. In addition, as referenced above, the Competition CBA will consider any costs associated with potential delays. We therefore do not agree with the TO view that the model will negatively impact on security of supply or delivery of Net Zero.

3.13. Within our consultation we explained that there is evidence that indicates that the utilisation of competition, both late and early, is able to deliver significant savings against the counterfactual of monopoly delivery. As explained in the updated IA, we continue to consider that the 22%-42% benefit range referenced in the IA accompanying our consultation is robust.

3.14. Our updated IA recognises that the relevant financing arrangements under this counterfactual regime is a relevant consideration in any calculation of relevant benefits. It explains that we do not agree that the WACC set for RIIO-2 is sufficiently low as to offset the level of benefit that early competition has been able to unlock internationally.

3.15. TO responses have also suggested that the bulk purchase and co-ordinated development of projects by TOs allows them to deliver significant savings that are not deliverable through early competition. They therefore consider that the development of early competition is not required. We do not find these arguments persuasive. We are yet to see clear evidence that this is an approach that has been utilised previously on projects identified through the existing NOA process. It does not appear to have featured prominently in TO business plans for the RIIO-2 price control. It is also not clear how such an approach is compatible with the TO position, as we understand it, that they require regulatory approval through the Final Needs Case process under LOTI before committing expenditure to delivering these projects under the prevailing RIIO-2 price control arrangements. Finally, and most critically, where such a co-ordinated "bulk supply" of necessary projects can be identified and approved for delivery, it has not been explained why, if there are potential benefits with this approach, they can only be delivered by incumbent TOs. It is unclear why an equivalent level of benefits can't be achieved by a third-party through early competition, particularly where there are projects that can be 'clustered' together or where there is a repeat pipeline of competed projects.

3.16. We remain committed to working with the ESO to fully develop an early model of competition that will deliver benefits for consumers. We clearly recognise that stakeholders have concerns about the design of the model that will need to be developed further between ourselves and the ESO as the prospective Procurement Body. We will ensure that the full range of concerns from all respondents are appropriately considered as we work towards finalising the commercial model.

4. Identifying which network needs are likely to be suitable for early competition

Section summary

This Chapter summarises our decision on how network needs will be identified as suitable for early competition and how the criteria for early competition should be calibrated.

Introduction

4.1. Within this Chapter, we summarise our conclusions on whether there is a case for very early competition, along with the criteria and process for determining which proposed investments on the network are suitable for early competition.

Comparing early competition to very early competition

4.2. As referenced in paragraph 2.5, 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. 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 high-level indicative solutions are identified, this is referred to as "very early competition". For the purposes of this document, if the tender takes place slightly later, after an indicative solution has been identified, this is referred to as "early competition".

4.4. In our consultation we recognised that it is difficult to see how a very early competition model could be implemented without introducing a significant level of uncertainty and complexity to the wider network planning and tender evaluation processes. We explained that this is because the outcome of the very early competition could have a significant impact on the optimum design of 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 could change during the procurement process as the scopes of other, related projects, are refined. In contrast, by using an indicative solution to set the required deliverable from the tender,

the impact of the option selected on other network needs across the network would be limited. We sought views from stakeholders on how a very early model 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.

Summary of consultation responses

4.5. All three TOs agreed that very early competition would be very likely to be too complex to run without having a negative impact on planning the rest of the network and would introduce significant uncertainty. One TO added that it would be difficult to propose solutions under very early competition.

4.6. One non-TO respondent agreed that very early competition would have a negative impact on the rest of the network and noted that it would be complicated to assess bids under very early competition. Another respondent disagreed, noting that both early and very early competitions should be developed, assessed, and run on their own merits. However, this respondent did not identify any specific situations where very early would be preferable to early competition.

4.7. One stakeholder requested more clarity on the detail of what the exact parameters would be for a very early model tender compared to an early model tender. In particular they sought additional detail on how the scope of an early model competition tender would be defined.

Additional consideration since the consultation

4.8. The network planning process used to determine the needs of the network has a clear interaction with whether it is feasible to run a very early competition. The initial findings of our Electricity Transmission Network Planning Review (ENTPR) are therefore relevant considerations in reaching our conclusion on this point. Whilst the development of competition models is outside the scope of the ENTPR, our initial findings did look at ways that the existing NOA process could be updated to allow for the network to be planned more strategically, holistically, and pro-actively.

Our conclusions

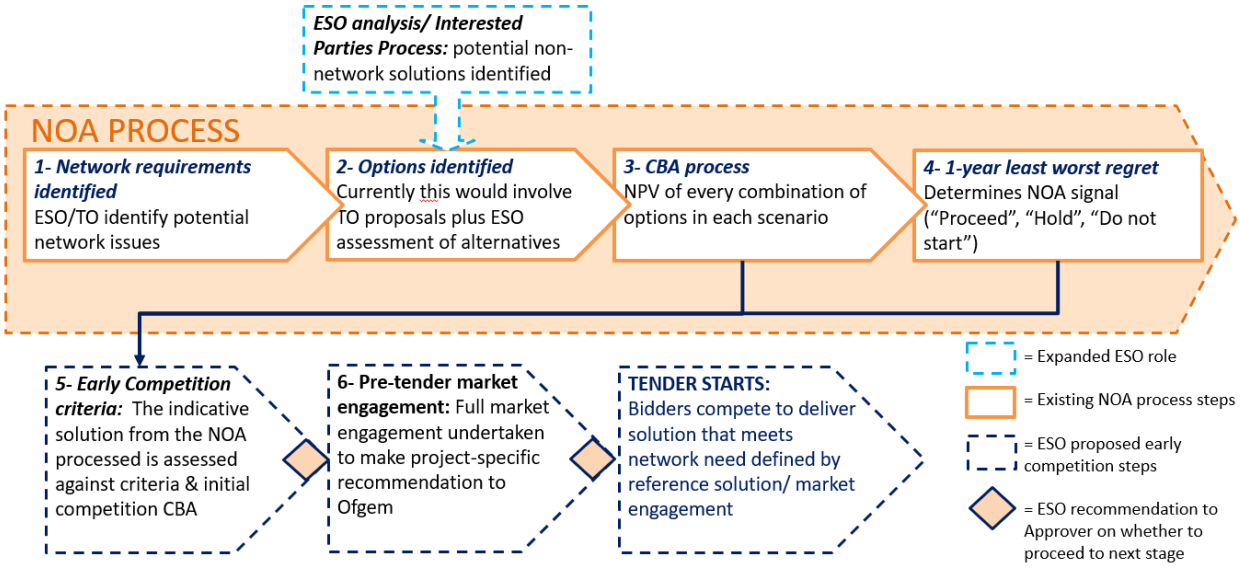
4.9. We remain open to considering very early competition where circumstances suggest that this is in the interest of consumers. However, since no respondents were able to identify any specific types of network needs, or network locations where such an approach would be appropriate at this stage, we have concluded that it is appropriate to continue to work with the ESO to develop an early model of competition for network needs on the ET network. The early model as developed by the ESO would define the scope of a competition based on an indicative design. This will keep the progression of other system needs and projects 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.

4.10. In terms of clarifying the exact distinction between how the tender is scoped for an early competition versus a very early competition, the key differential is that early competition includes the specification of locational as well as technical requirements. This reduces the impact of the bidder solutions on the wider network. Under an early competition, bids will need to deliver the same specific technical network benefits as those provided by the indicative solution used in the network planning model, and in the same location(s) on the network.

Defining the technical scope of a tender under an early competition

4.11. In our August consultation, we explained that we considered the ESO had proposed a sensible approach to determining which network needs should progress to early competition.

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



4.12. Below we summarise the ESO proposals with reference to Figure 3, which was included in the consultation.

1. As shown in step one of Figure 3, the ESO identifies existing network capabilities, and uses the FES scenarios 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 it to develop potential investments that are able to improve the ET network's capability to address these future requirements. Third parties are also provided with this information and can submit options through the Interested Persons' Options process.

2. At step two, the 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 Options Process[21].. It is possible that the Interested Persons Options Process may in future identify solutions that outperform other options within

[21] The Interested Persons' Options 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 gives demonstrable evidence of benefit to meet system needs, there is scope for the ESO and TOs to provide additional support and analysis.

the analysis undertaken to determine the indicative solution to a network need, meaning that these solutions would play an integral role in setting the specification of an early competition tender.

3. At step three, as currently happens as part of the NOA process, 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 Service Date (**EISD**)[22]. 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.

4. At step four, 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.

5. At step 5 the ESO's proposal was that all projects that are identified as being part of the optimal mix of projects, including those that do not need to start immediately, should then be assessed against the criteria for early competition (as set out in paragraphs 4.32 - 4.50).

6. At stage 6, where any indicative solution from the NOA process meets the early competition criteria, it is subject to the 'initial competition CBA'. The initial competition CBA determines whether early competition is likely to deliver savings to consumers relative to the counterfactual approach under the RIIO arrangements. Where an indicative solution progresses beyond the CBA, subject to Ofgem approval, it would then 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

[22] 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.

would carry out the final competition CBA and make a recommendation to Ofgem as the Approver[23], on whether the tender should start.

4.13. 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 satisfy.

Summary of consultation responses

4.14. All three TOs noted that they had concerns over the limitations and practical challenges associated with using the NOA process. One TO questioned whether the NOA process was the right process to engage market participants. TOs also raised concerns with the project need disappearing or changing.

4.15. Another TO noted they do not consider it feasible to run so many initial competition CBAs.

4.16. TOs also noted concerns over the analysis done to underpin the duration of the need. One TO in particular alluded to pathfinders, where they felt it is difficult to understand the analysis that has been undertaken to underpin the duration of the need that is being tendered. The respondent suggested that ignoring the potential need, benefit, and cost beyond the initial tendered period (e.g., beyond ten years) risks leading to greater costs in the long term for consumers.

4.17. A TO respondent raised concerns around the potential inclusion of large asset replacements. It had concerns regarding the issue of "Separability" and stated that further work is required to clarify ownership and responsibilities in this type of project. This stakeholder also stated that more consideration and explanation is needed on how the tender process determines the length of need and capturing any residual value beyond the period tendered for. They noted that understanding the duration of the need

[23] 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.

is critical to ensuring the right overall solution is provided and therefore consumers receive good value for money.

4.18. Of the other responses, respondents raised concerns over the current level of access that non-network solutions have to the NOA process through the Interested Persons Options Process. Some respondents also stressed the importance of ensuring that the NOA is able to accommodate any additional analysis without causing delay to necessary investment.

Additional consideration since the consultation

4.19. The proposed arrangements explained in paragraphs 4.12 to 4.13 were developed by the ESO based on the existing network planning process under the NOA.

4.20. Since our August consultation, the initial findings from the ETNPR have proposed that the annual NOA process should be improved and superseded by the development of the CSNP process that runs every 2-3 years.

4.21. Table 1 in Chapter 4 of the ETNPR initial findings sets out our view of what this CSNP process might look like. The table is shared in full in Appendix 1, with the high-level steps identified below:

1. ESO as the Central Network Planner (**CNP**) models Future Supply and Demand
2. CNP identifies the system need
3. CNP along, with TOs and Third Parties, identifies suitable investment options
4. CNP carries out a Cost Benefit Analysis (CBA) on the identified options
5. CNP develops an optimised CSNP
6. CNP and Ofgem are responsible for regulatory sign off and the determination of the optimum delivery model (including competitively via third parties)
7. Party responsible for delivery develops the detailed solution

4.22. Whilst the CSNP is likely to differ from the existing NOA process, we consider that it is compatible with the ESO proposals for determining the technical scope of an early

model competitive tender. Moreover, its 2–3-year timescale should provide greater certainty to TOs and third parties by enabling future planning and providing robust and transparent Future Supply and Demand scenarios.

Our conclusions

4.23. We consider that the ESO's proposed approach to determining the technical scope of an early model competition remains sensible. We do not agree with the TO suggestion that the ESO's proposed process as identified in our consultation would not be able to be incorporated into the limitations of the annual NOA process. The consideration of third-party solutions is a logical extension of the existing analysis, whilst the pre-market engagement and tender stages can and would clearly sit outside of the annual NOA milestones.

4.24. Having said this, we consider that the CSNP as proposed in the ETNPR initial findings is compatible with the ESO's proposed process identified in our August consultation and will offer clear additional benefits for the identification of early competition relative to the existing NOA process.

4.25. We consider that the process that leads to the development of the CSNP (stage 5 in the numbered list under paragraph 4.21) is comparable to steps 1-4 of the process the ESO proposes in paragraph 4.12. We therefore conclude that the proposed investments that form the output of the CSNP can be assessed against the criteria for early competition in the same way as the outputs of the existing NOA process can. Where any final decision as part of the ETNPR is incompatible with assessing proposed investments against the criteria for early competition, we will consult on how this will be carried out as part of the ETNPR.

4.26. Whilst we disagree with the TO views that it would be too complex and inappropriate for NOA process to fully consider third-party solutions, we note that the movement from the existing annual NOA process to the CSNP every 2-3 years should allow for more time for robust and detailed comparative assessment of TO proposals and the serious and more detailed assessment of potential third-party alternatives.

4.27. With regards to concerns about the number of CBAs that would need to be run, this criticism appears to be based on a misunderstanding. It is the indicative solution used in the early competition CBA, rather than each potential alternative solution imaginable.

Defining the criteria used for identifying projects for early competition

4.28. As part of our work on developing late models of 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 projects[24], where ownership and responsibility can be separated clearly from the rest of the network, would be the most 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.

4.29. 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.

4.30. As explained in our consultation, the ESO recommended that the criteria for early competition, which each indicative solution from the NOA is assessed against, should be as follows:

- New and Separable
- Certain – For example, if 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.

4.31. The ESO did not recommend a minimum value threshold. They did not think there was a clear minimum project value beyond which overall benefit could not be achieved.

[24] A complete replacement of existing assets is also included in the definition of 'New'.

They did recognise however, that there may be other sensible reasons for introducing such a threshold.

4.32. Below we set out, for each aspect of the criteria, our consultation position, summarised views from consultation responses, any additional considerations since the consultation and explain our conclusion.

Whether there should be a value threshold

4.33. In the consultation we agreed with the ESO's proposal that a project-specific CBA would negate the need for a minimum value threshold. Having said this, we did recognise that there would be potential benefits in providing certainty to TOs around which projects would be likely to be subject to competition via the early model. We proposed to reach a view on the suitability of a value threshold alongside a more developed CBA methodology and project identification process.

Summary of consultation responses

4.34. A wide range of stakeholders recognised that a high-value threshold would be beneficial for TOs by providing them with greater certainty on the projects that would not be eligible for early competition. It was also suggested that a value threshold would be beneficial to bidders as they would have greater certainty on the likely number of projects that would likely feature in the future pipeline of projects that are suitable for early competition.

Additional consideration since the consultation

4.35. Since our consultation, we have further explored the value of projects considered through the 2021 NOA and further considered evidence around the value of projects likely to deliver benefits to consumers through competition. In parallel the ESO has continued to develop a draft competition CBA methodology, which will be subject to separate consultation.

Our conclusions

4.36. Whilst we recognise the benefits for TOs and bidders of having certainty around the value of projects likely to proceed through to an early competition tender, we consider the potential benefits through innovation that early competition can deliver, could also benefit projects that are of relatively low value. We therefore do not consider that it would be possible, at this point in time, to implement a minimum value threshold

that would provide meaningful benefits to bidders/TOs without providing a disbenefit to consumers via a restriction of the types of network needs that could benefit from early competition. As the competition CBA process and methodology are established and stakeholders become more familiar with them, it should become clearer to potential bidders and incumbent TOs as to which sorts of network needs are likely to be eligible for early competition.

4.37. We will revisit this decision once the CSNP process is fully developed and the first projects are identified as suitable for early competition.

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

4.38. Our consultation explained that we consider that the ESO's proposed 'certainty' criterion, defined as the indicative solution being needed in more than one FES scenario, is reasonable. We considered that it balanced 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.

Summary of consultation responses

4.39. Several respondents, including the TOs, opposed a move away from the new, separable and high-value criteria developed for late model competition. However, most respondents recognised the need to balance ensuring that projects are considered for early competition as early as possible, with ensuring that bidders can have sufficient comfort that the projects under consideration are not speculative investments. It was felt by some, however, that the proposal of "certainty" being defined as an investment needed in more than one FES scenario felt arbitrary and lacking in transparency for potential bidders.

Additional consideration since the consultation

4.40. One of the key topics of ETNPR is "Analysis and decision-making methods for network planning against uncertainty". This considers, amongst other things, the link between FES and network planning tools such as the NOA. As part of our enduring vision for the CSNP, our initial findings explained that "In terms of modelling supply and demand, we consider that a case could be made to move away from the current broad scenario-based approach used in the FES to a less mechanistic approach that makes

assumptions, at least for the nearer term future, that are governed more by strategic thinking".

4.41. In this context, we recognise that it may not be appropriate to define the "certainty" criteria for early competition as being defined as an investment needed in more than one FES scenario.

Our conclusions

4.42. We have concluded that "certainty" is an appropriate criterion for early competition. This is because the need to identify network needs early, whilst ensuring that bidders have sufficient certainty that the need will not fall away or change, will be critical to the early competition model being successful.

4.43. In line with our August consultation, we consider that the ESO's proposal of defining 'certainty' based on network needs that will need addressing in more than one FES scenario represents an appropriate balancing of these key factors. However, we recognise that this approach may not be compatible with the initial conclusions of the ETNPR.

4.44. Through a review of the last two versions of the ESO's NOA publication, we note there have been very few projects that have progressed to the optimal path within NOA which were only needed in one FES scenario. The optimal path in NOA is effectively a consolidated list of all the projects that the CBA suggests are in the interest of consumers at that point in time. They are then identified in the NOA as getting a signal to "Proceed" where it is optimal for the projects to start in the next year, or "Delay" or "Hold" if the CBA suggests that they are needed, but it is not the optimum time for them to start yet.

4.45. The vast majority of projects in the optimal path are normally required in all scenarios, including those with a "Delay" or "Hold" signal. A review of the last two NOA reports, from 2021 and 2022, suggests that typically less than 5-6% of projects in the optimal path are only required in one FES scenario, all others met the ESO's proposed definition of the "certainty" criterion. We therefore consider that defining the "certainty" criteria as those projects that have a "Proceed", "Delay" or "Hold" signal provides an equivalent level of certainty to the ESO's original proposal, whilst also being better aligned with the initial conclusions of the ETNPR project. This is because, whilst the Enduring CSNP arrangements may not specifically use the terms "Proceed", "Delay" and "Hold", it will inevitably need to identify projects that need to progress straight away,

and those projects that are needed but don't need to proceed straight away. We therefore conclude that the "certainty" criteria should be confirmed as those projects with a "Proceed", "Delay" or "Hold" signal as this definition aligns with the original ESO proposal that was consulted on, whilst also better aligning with the evolution of the CSNP within the ETNPR project.

4.46. If the ETNPR determines alternative terminology within the eventual CSNP to distinguish between projects that need to proceed now, and projects that are needed but don't need to proceed straight away, we will update the "certainty" criterion for early competition accordingly.

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

4.47. In our consultation we set out that we did not consider that "new" and "separable" were as relevant for early competition as they were for late competition. This was principally because under early competition there may be network issues where it is theoretically possible that third parties may be able to propose alternative solutions to what the network planning process may assume is likely to be a non-separable solution. We were concerned that implementing "separable" as a criterion for early competition would effectively exclude these network issues from ever being eligible for early competition.

Summary of consultation responses

4.48. Of the respondents that specifically addressed this point, there were a range of views. Two of the TOs specifically favoured retaining "separable" as a criterion to provide them with greater certainty around which projects would or wouldn't be eligible for competition. Other respondents emphasised the importance of ensuring that as wide a range of network issues as possible are considered for early competition.

4.49. Within its response, the ESO recognised our concerns around unnecessarily limiting the network needs that are eligible for early competition. It also emphasised that there would likely be a lot of network needs where it will not be feasible for a separable solution to be economically viable in comparison to certain non-separable solutions that only the incumbent TO would be able to deliver. It suggested an adjustment to its proposal for the "separable" criterion, in order to also include any network needs where a non-separable solution is assumed in the network planning process, but where the

ESO considers that it is feasible that a third-party may be able to offer an economically separable alternative.

Our conclusions

4.50. Having considered all representations, we conclude that, on balance, the amended definition proposed by the ESO for the separable criterion is the best approach. By including any network needs where a non-separable solution is assumed in the network planning process, but where the ESO considers that it is feasible that a third-party may be able to offer an economically separable alternative, we should be able to ensure that these opportunities for innovation to be driven through early competition are realised. Moreover, this would also provide the TOs and bidders with more clarity than if the separable criterion was removed entirely.

5. Roles and Responsibilities within Early Competition

Section summary

This Chapter provides a summary of our decisions on the ESO's proposal for roles and responsibilities required to facilitate early model competition.

Overview

5.1. As explained in our consultation, the ESO and TOs carry out key roles within the existing industry arrangements for onshore electricity transmission network planning, design and delivery. 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 2019[25] 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. In our August consultation we set out our views on the ESO's proposed roles and who we felt is best placed to carry them out. Below we provide our updated view and decisions following consideration of consultation responses.

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

The proposal for the ESO to undertake the Procurement Body role

5.4. Our August consultation explained our views on the roles that the ESO proposed it should play in early competition. We outlined that the Procurement Body role as described by the ESO in its ECP represents a logical extension of its existing role. We therefore agreed the ESO was best placed to undertake this role and that the ESO proposals were consistent with the proposed direction of travel for the FSO workstream. We welcomed respondents' thoughts on whether they had any concerns over the ESO expertise, incentives, or independence, should they be appointed to carry out the Procurement Body role for early competition.

5.5. 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.

Summary of consultation responses

5.6. Of those who responded to this question, the majority agreed with the proposal for the ESO to undertake the Procurement Body role, although many highlighted concerns over the ESO's perceived level of independence. Whilst respondents acknowledged there has been work to date legally separating the ESO from National Grid Group's transmission owner licensee, NGET, respondents noted that the ESO would require full independence should it be chosen to undertake this role. To combat this, one respondent suggested there should be a definitive timetable set for the ESO to become fully independent, to remove any perceptions that it may not be sufficiently independent from all bidders. Another respondent noted that considering the BEIS and Ofgem consultation on the potential establishment of an FSO, a future governance structure should first be determined and then following this, there should be a review of the appropriate competition roles and responsibilities across parties to help ensure that the right skills and capabilities are in place.

5.7. Some respondents additionally noted concerns over the ESO expertise, should it be chosen to carry out the Procurement Body role. They noted that the ESO would need to upskill before doing so, to have the right capabilities and skills to carry-out this role effectively. Citing concerns over challenges presented under the current pathfinder process, and concerns over the length of time needed for them to upskill, they emphasised that procuring services from the market differs from procuring design and

delivery of strategic infrastructure. One respondent suggested this could be addressed through a mix of direction from Ofgem and consultants, until the ESO builds up its expertise. Another respondent suggested that Ofgem should undertake this role, due to its experience in running Offshore Transmission Operators (**OFTO**) tenders.

Our conclusions

5.8. Following careful consideration of responses to our consultation we continue to consider that the ESO is the body best placed to take on the Procurement Body role. We consider that the scope of the Procurement Body under ESO's proposals is consistent with the FSO proposals as set out in the FSO consultation and ETNPR initial conclusions in terms of strengthening the role of the ESO in network planning as an independent body.

5.9. We agree with respondents that there needs to be a clear distinction and separation of the ESO from any TOs to ensure confidence in its independence and absence of bias. We agree with respondents that this separation would preferably be completed before the first competition is run. We expect that the current expected timeline of events will allow for this to happen. However, if the FSO project is delayed or the decision is made not to go ahead with the FSO proposals, we will consider possible alternative measures we might take that would feasibly address the issues respondents raised with regard to ESO independence.

5.10. Regarding the concerns raised over the ESO's potential shortfall of skills and expertise required for it to be an effective procurement body, we recognise that the role will require expertise beyond those it currently relies on to run the Pathfinder process. We consider that the flexibility within the ESO's RIIO-2 arrangements allow for the ESO to develop its expertise and address any skills gaps. With this confirmation of the ESO's responsibilities, we expect that there should be sufficient time for the ESO to acquire the appropriate resourcing before the initiation of the first competition process.

Proposal for Ofgem to undertake Approver and Licence Counterparty roles

5.11. Our August consultation document outlined that we agreed with the ESO proposals for Ofgem to undertake the Approver and Licence Counterparty roles. We explained that these roles align with our existing remit as the sector regulator and existing legislative arrangements. We welcomed respondents' views on whether they agreed with Ofgem undertaking Approver and Licence Counterparty roles.

5.12. The role of approver would involve making the formal decision to progress at each of the stage gates within the ESO's proposed early competition model (before, during and after an early competition tender). The Approver role will ultimately be responsible for ensuring that the project progressing to early competition is, and remains, in the interest of consumers. 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.

5.13. As part of our considerations, we outlined our view on Ofgem's role during the tender process and specifically that we did not agree with the ESO view that we should be approving the Preferred Bidder. We considered there should be a clearer distinction between the Procurement Body and Approver roles. The Procurement Body will run the procurement and therefore should be responsible for all elements of the tender process.

Summary of consultation responses

5.14. Of those who responded, the majority agreed that Ofgem should undertake both the Approver and Licence Counterparty roles. Respondents additionally agreed that Ofgem should have an "oversight" role. Stakeholders welcomed more information on the details of what this role would include. One respondent felt Ofgem's role should include determining whether there have been any material changes to the tendering arrangements, ensuring the tender is being run in a fair and transparent way and reviewing and signing-off the tender and evaluation process prior to a tender being launched. One stakeholder added that they felt the consultation did not go into enough detail on how Ofgem would grant licences, or Ofgem's role in the regulation of successful bidders. The same stakeholder felt that the consultation indicated that these matters will be left to the ESO.

5.15. A small number of respondents agreed with the ESO that Ofgem should approve the preferred bidder, with one stakeholder concerned that time could be lost should Ofgem have no role in approving the Preferred Bidder and potentially rejecting the Preferred Bidder's licence application later in the process.

5.16. Another respondent noted that Ofgem should retain an equivalent level of oversight of the contract counterparty as this would ensure equivalent protection for consumers irrespective of whether a licence or non-licence solution is pursued.

Our conclusions

5.17. Following careful consideration of responses to our consultation we remain of the view that Ofgem is the body best placed to take on the Approver role and Licence Counterparty role. We also stand by our view that this role should not include the responsibility for approving the preferred bidder after the Procurement Body has run the tender process. As per our decision in paragraph 5.8, we consider that the ESO is the best placed party to take on the Procurement Body role, and therefore it will have the best knowledge and expertise for determining the preferred bidder.

5.18. As the Approver, Ofgem will maintain an oversight role of the competition process ensuring that it remains in the best interests of consumers at each stage. This role will also include ensuring that the tender is being run in a fair and transparent way as Ofgem will be drafting the relevant regulations, approving the documentation used to run the tender as well as maintaining our regulatory relationship with the ESO.

5.19. As the Licence Counterparty, Ofgem will issue licences to successful bidders. We will act within our remit as the regulator and in accordance with the Electricity Act to ensure that existing TO licence holders and winning bidders that are awarded a licence are treated fairly and proportionately considering their network assets. Our aim is to create a level playing field for both current TOs and any future competitively appointed transmission owners. This will ensure that we encourage future bidders, as well as ensuring that the ET network is carefully managed and regulated.

5.20. Across our roles in early competition, we consider that any bidder concerns around a transmission licence not being awarded to a Preferred Bidder, or a contract award being vetoed can be mitigated effectively. Ensuring that the Preferred Bidder is able to undertake the necessary functions to be awarded an electricity transmission licence will be a key consideration of the Licence Counterparty role[26]. It will therefore be critical that all bidders are aware of what these requirements are ahead of the competition. In our role as the Approver, we will draft the relevant regulations, sign off the tender documentation, oversee the tender process and also ensure at the relevant Stage Gates, that the proposed solution remains in the interest of consumers. In addition to our own monitoring of the tender, the parties will be required to inform us of

[26] Latest guidance on applying for licences can be found on our website: Applying for a gas or electricity licence (ofgem.gov.uk),

any material changes during the course of the tender so that we can indicate any material concerns we have and/or requirements for further needs case assessments at that time, rather than at the end of the tender process. We disagree with the respondent that suggested that Ofgem is best suited to take on the Contract Counterparty role as well. We do not consider that it would be appropriate for Ofgem, as the regulator for the sector, to enter into contracts for network services. We stand by our proposal for the ESO to undertake this role. Further detail on the Contract Counterparty role can be found in the section below.

Proposal for the ESO to undertake the Payment Counterparty and Contract Counterparty

5.21. Our August consultation outlined that we agreed with the ESO's proposals of the ESO undertaking the Contract Counterparty and Payment Counterparty roles.

5.22. The Contract Counterparty, as set out in the ECP would be responsible for setting, managing, and monitoring any obligations placed on a successful bidder that is issued a contract.

5.23. The Payment Counterparty, as set out in the ECP would be responsible for managing financial transactions with the successful bidder.

Summary of consultation responses

5.24. As we did not specifically ask about these two roles there was limited feedback from respondents on the proposal for the ESO to assume these positions. The one piece of feedback we received on this was from a TO. They stated that they consider it is essential that the Contract Counterparty maintains the same authority as the Licence Counterparty to ensure that any contract obligations and penalties are equal for network and non-network solutions. This respondent also asked for further clarity on what enforcement measures the ESO will be able to enact in the case of third-party poor performance or failure.

5.25. The same TO also requested that Ofgem provides further definition on what "non-network solutions" consist of, stating that it is unclear if non-network solutions also include non-network assets.

Our conclusions

5.26. No concerns were raised in consultation responses about the ESO undertaking these two roles. As we outlined in our consultation, these roles are already closely aligned to existing responsibilities of the ESO. Whilst we understand that the contractual arrangements under early competition have the potential to be more complex than existing arrangements, we consider that the ESO is well positioned to develop the necessary expertise. Contracts form a key part of the tender process, which is designed by the Procurement Body and therefore the ESO, as the Procurement Body, would have best insight into the design of contracts. However, Ofgem would have oversight of contracts and the tender process, with the power to intervene if required.

5.27. As for the Payment Counterparty role, we expect the magnitude of changes to existing arrangements for the ESO to undertake the Payment Counterparty role should be relatively low. We expect these changes to fit comfortably within the remit of the ESO's expertise and therefore, still consider the ESO to be the body best suited to undertake this role.

5.28. Respondents raised concerns around the differences in authority and enforcement between Ofgem as the Licence Counterparty and the ESO as the Contract Counterparty. It is our aim to ensure that the licence and contract arrangements are aligned as much as reasonably possible so that network and non-network solutions are considered and regulated fairly and appropriately. Our aim is for the contracts to replicate equivalent duties to that of a licence, so that parties are treated correspondingly, so far as appropriate.

5.29. Regarding the definition of a non-network solution, we maintain the definition as proposed by the ESO, that non-network solutions are any solutions that do not meet the requirements to be awarded a transmission licence.

The Network Planning Body role, and the role for TOs in network planning

5.30. The ESO proposed in the ECP that it should strengthen its existing role in network planning. Under its proposal, as Network Planning Body, it 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 consideration of alternative solutions to those proposed by TOs.

As part of this, the ESO notes it expects the TO (under its proposed Network Planning Body) to have a role in assessing the impact of the shortlisted technical solutions at Invitation to Tender (ITT) stage 1 and a role in testing any impact of those solutions on their (i.e. the TO's) network.

5.31. We stated in our consultation that we consider the Network Planning Body role, as proposed by the ESO, to be a logical extension of its current network planning and development responsibilities. We also stated that we consider the ESO proposals to be consistent with the direction of travel of both the FSO proposals and ETNPR, but that we would keep this under review in light of any changes to the ESO's roles and structure.

Summary of consultation responses

5.32. Of those who responded to this question, only TO-respondents held the opinion that this role should stay with TOs. They considered that they have the expertise, resources and skills required to develop projects and optimise the network to meet consumers' needs. These TO-respondents further added that the removal of network planning responsibilities will not promote efficiency and economy in electricity networks, as the proposals risk undermining the ESO and TO general duties under Section 9 of the Electricity Act 1989 to "develop and maintain an efficient, co-ordinated and economical system" of electricity transmission, a duty which also applies to the ESO under its licence.

5.33. These TO-respondents also felt that the ESO would not be best placed to undertake increased network planning responsibilities, as this is not expertise which the ESO currently holds. They added that strengthening the network planning role of the ESO would require increasing the ESO's skillsets to include project development, and engineering expertise. Furthermore, they expressed concerns over the time that it would take to build this capability, considering the need for delivering projects at pace to meet the UK's Net Zero ambitions. These respondents stated that these areas of expertise already sit with the TOs and duplication within the ESO is not necessarily efficient.

5.34. The ESO's view was that it should work alongside TOs for this role, explaining that it believes the expertise of the TOs to be highly valuable. However, it also proposed that all possible options and solutions should be considered in this part of the process, not being limited to TO options and solutions.

5.35. One TO-respondent also felt that Ofgem had failed to consider the extent to which TOs undertake community engagement and consenting activities as part of their network

planning responsibilities. This respondent felt that if another party were undertaking this role, it could damage existing relationships and increase complexity, in-turn causing delays. They felt that the ESO is not best suited to undertake this role, noting that it does not have the experience or skills, nor understanding of specific challenges such as the North of Scotland network.

5.36. Another TO-respondent felt that TOs should be involved in the network planning process, particularly with the initial needs identification. They felt that TOs should provide information to support works and to check that proposed solutions are safe and compliant. They proposed that TOs should provide the ESO with information, which it would use as it sees fit for the competition process. They also stated that TOs should have no influence on how the information is used to ensure that the process is fair and unbiased. Another concern raised by this respondent was relating to the funding of data requests relating to competition, stating that this will need to be considered separately to the TOs' usual operational funding.

5.37. Four stakeholders disagreed with the above and felt that the Network Planning Body role should sit with the ESO. One respondent stated that they believe it is important for both TO and non-TO input to be considered as part of the network planning process, proposing that TO ideas are submitted via the "interested persons" process. Another respondent felt that the ESO should have the sole responsibility for designing the ET network and TOs should become asset managers (similar to OFTOs) and have no role in the tender process, other than to provide non-bidder specific information about their network. The final respondent noted their view, that the Network Planning Body role should be undertaken by the ESO and DSOs. They recommended these bodies should plan networks, and that TOs and DNOs should be consulted on the development plans.

Our conclusions

5.38. Following careful consideration of responses to our consultation, we still consider that the ESO is the body best placed to take on the Network Planning Body role within early competition, supported by a continuing role for the TOs.

5.39. We disagree with the TO view that the ESO as Network Planning Body would undermine the TOs' ability to develop and maintain an efficient, co-ordinated, and economical system. Our ET Network Planning Review is considering this matter further in terms of revisions to roles and responsibilities for TOs and the ESO in network planning, and associated changes to industry codes and network licences. We consider that the

Network Planning Body role under early competition will align with those new arrangements.

5.40. Our aim is to widen the range of potential solutions within the early competition as much as possible to encourage innovation. This requires that the body responsible for this has the appropriate incentives to both identify these options and ensure that the correct decisions are made to ensure greatest benefits for consumers. In line with the FSO proposals, as set out in the FSO consultation and the initial conclusions of the ETNPR project, we believe the ESO (and if the FSO proposals are taken forward, then FSO) will be appropriately skilled and incentivised to carry out this role fairly, responsibly and to a high standard.

5.41. We acknowledge that the ESO does not necessarily currently have the skills or expertise to sufficiently develop alternative reference designs as part of the network planning process, and that it will take time for it to develop the required skills. We expect that the potential timeline of early competition development will allow for this to happen in time without diminishing the benefits of competition for consumers. For this reason, we are not concerned that UK Net Zero targets will be negatively impacted by the transition of the ESO taking on this role.

5.42. If the decision is made to go ahead with the FSO proposals the ESO's role can begin progressing towards the FSO. This should give bidders confidence that options put forward by the proposed impartial FSO have been selected without bias towards TO development and that options are selected in the best interests of consumers. This model also benefits from maintaining the knowledge and expertise of TOs in the planning process by including their proposals in the consideration of network planning. We agree with the ESO's proposals that it is important to maintain this knowledge, but in a way that is fair and will not undermine potential bidders' confidence in entering the competitive process.

5.43. We do not expect DNOs to play a formal role in the planning of ET network developments. However, the ETNPR project will consider the best way of managing the interactions between the CSNP and the distribution networks, although this falls outside the scope of this decision.

Proposed conflict mitigation arrangements for TO roles and the appropriate level of challenge for the ESO

5.44. Our August consultation noted that as a general premise, early competition should be open to the widest range of possible solutions and pool of bidders, to compete against each other to address a specified transmission need. We broadly agreed with the ESO's proposals that TOs should be allowed to participate as bidders subject to certain conflict mitigation requirements. To address the above, we flagged two options as considered by the ESO:

- **Option 1** – to require the ringfencing of TO bidding teams and to introduce ESO challenge of TO initial solution development.
- **Option 2** – transferring relevant network planning responsibilities for projects that progress to early competition from the TOs to the ESO.

5.45. In our August consultation we stated that 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 represented the mitigations we had previously proposed for TO bidder involvement in late competition.

5.46. Under option 1 the ESO proposed that TOs would undertake feasibility assessments of the impact of proposed solutions on their network. We stated that in our view it is necessary to consider which party is best suited to take on this responsibility, either the TOs, ESO or possibly a technical consultancy firm.

5.47. In principle, we welcomed the suggestion that the ESO should challenge the TO's initial solution development. However, as this would represent a change to the ESO's current responsibilities, we stated that we would want to be satisfied that the ESO could carry out this new function efficiently and effectively.

Summary of consultation responses

5.48. Respondents identified a number of potential conflicts of interest in the proposal for TOs to be allowed to be bidders in early competition. The risks identified occur at various points in the tender process. Initially, before the tender process, there are two key risks: the potential manipulation of options within the NOA or CSNP process by TOs, and TOs having greater time to refine their bids due to their early role in options development. Secondly, during the tender process there is the risk that TOs would have a role in assessing network impacts and compliance of bidder solutions, and therefore

may be biased in their assessments or data sharing. Lastly, a concern that TOs may be able to use cross-subsidies from RIIO to deliver lower bid costs, for example in the operational period, to give them an advantage in competing bids.

5.49. Whilst we received a mixture of views to this issue, most potential bidders agreed that both proposed conflict mitigation arrangements did not go far enough to mitigate conflicts. Of the options presented, one respondent noted that option 1 – to ring-fence bidding teams, appeared to be the least disruptive route. However, they had concerns that there may be limitations if applied without further thinking and details, suggesting that time-limited ring-fenced approach may be appropriate to minimise disruptions (cost and resources). Specifically this respondent emphasised the need for further clarification of which roles and responsibilities are to be subjected to ringfence arrangements and for how long these would be in place. In their view this clarification would be important to avoid unnecessary duplication of costs incurred by the TO within the network planning process.

5.50. Two respondents agreed that option 2 – transferring relevant network planning responsibilities for projects that progress to early competition from the TOs to the ESO would be their preferred solution, as whilst this would represent a significant change, transferring all network-planning responsibilities would create a 'deep' ESO with the necessary skills (transferred from the incumbent TOs) which would resolve concerns with the ESO expertise, resources, and efficiency.

5.51. Separately, two TO-respondents flagged multiple concerns over the proposed conflict mitigation arrangements. Firstly, that the conflict is based on a perception rather than a proven conflict. Secondly, that there is no evidence that ring-fencing will benefit consumers, nor any evidence on the impacts of this proposal on the development and maintenance of the network, suggesting that these are areas that need to be thoroughly explored. Lastly, they suggested that ringfencing bidding teams and the costs is not only impractical, but also not financially viable for TOs. As TO ability to partake in income generating activities outside their licensed area or licensed activities is limited, they therefore cannot raise finances to fund a ring-fenced bid team, should it not be funded by the price control. These respondents further added, unlicensed, third-party bidders can shift and reorganise their spending and finances freely to sustain operations, unlike TOs who are bound by their licence conditions and strict price control deliverables. They felt that when considered practically, this proposal may put TOs at a stark disadvantage in terms of financing bid teams.

5.52. These two respondents sought further clarity on what the proposed ring-fenced bid teams consist of. They suggest that a clear remit of responsibilities is required, as in practice, a bid team could be very large and may be split across multiple departments of an organisation. Additionally, the respondents further asked Ofgem to clarify whether a winning bidder that is awarded a transmission licence would be required to ringfence future bid teams i.e., once a third-party bidder wins a licence under the proposed early competition model, would it be expected to meet all the same obligations that TOs are expected to meet?

5.53. Two respondents commented on the TO's role within this section. One noting TOs should have no role in the tender process (including the network planning), or they should not be allowed to bid, or both. Another respondent noted that TOs should be excluded completely from very early competition should Ofgem in the future decide to go down this route.

Our conclusions

5.54. We want to ensure as many bidders as possible are encouraged to participate in the competition process, as we believe this will result in the best result for consumers. As TOs have a very significant amount of knowledge and experience in this field, we consider that, as long as the appropriate conflict mitigation arrangements can be put in place, they should also be able to enter bids into competitions. They also have the expertise and obligations to ensure that new network developments are safe, stable and do not have an adverse impact on their network. For this reason, we recognise the reason for the ESO's proposal that TOs should play a role in assessing bids. This does however raise very significant concerns around fairness and transparency in the competition process. It is important that these concerns are addressed thoroughly to ensure that the process remains fair and attracts as many bidders as possible.

5.55. The stakeholder responses assisted us in identifying the risks and conflicts associated with the proposal of including TOs in the bidding process. We agree that careful consideration must be given to address each of these risks before the first tender process is run. We have developed proposals to mitigate many of these key risks as much as possible. For the risks identified we intend to use a combination of the two options proposed by the ESO, as mentioned in 5.44, alongside the wider development of the role of the ESO through the proposed FSO and ETNPR projects. The risks we are addressing can be categorised by the stage of the bidding process that they would occur in i.e., before, during or after the tender process.

5.56. The risks that could occur before the bidding process include possible manipulation of the options within the network planning process used to determine the scope of the tender. For example, without sufficient oversight TOs could have the possibility of changing factors such as costs, or the EISD to make the options more suitable for TO development. We consider that there is scope to mitigate this risk by increasing the involvement of the ESO and third-party developers in network planning. This will be considered further as part of the on-going ETNPR project. The role of ESO as the Network Planning body is discussed above in paragraph 5.30 - 5.43.

5.57. Another pre-bidding risk is the concern that TOs would have more time to develop their bidding options, as they would have an early role in option development before the option is opened to third-party bidders. We consider that there is scope to mitigate this risk by imposing effective ring-fencing of the TO bidding team, so that they do not get early sight of the projects. This would need to be coupled with an emphasis on ensuring that the tender process has sufficient time for all bidders to fully develop their designs.

5.58. The key risk occurring during the bidding process is that TOs would be responsible for checking and assessing the impact of technical options in bids on the compliance of their (the TO's) network with all relevant network obligations under network codes and their licence. The concern being that TOs' bidding teams may have access to insider information that would benefit them over other bidders, as well as a potential bias for TOs to emphasise the technical risks associated with third-party bids.

5.59. We consider that there are a number of approaches that can be used to mitigate the impact of this risk. Firstly, there would be appropriate and proportionate regulatory consequences where TOs are found to have acted unfairly in these situations. Secondly, we agree with respondent views that effective ring fencing of the bidding team within the TO would be a necessary minimum step. Beyond this, bids will need to be assessed anonymously by the TO. We also consider that the sharing of as much network data and models as possible with all bidding parties has a key role to play. Although TOs will still need to carry out checks, the upfront sharing of the relevant network data should increase transparency for bidders and increase the extent to which they can carry out their own assessment of the impact of their options on the TO's network. We expect that the stronger oversight of the proposed FSO as a fully independent party would help to give bidders additional confidence in this process. Where appropriate this could be supported by the use of independent technical experts who could advise the ESO on assessing impacts of bids on the TO networks.

5.60. Lastly, there is the concern that TOs could artificially lower their bid costs to win competitions by using cross-subsidies from RIIO in the operational period. We aim to address this issue by developing an approach that would ensure accounting and reporting for such projects under Tender Revenue Stream (TRS)[27] are kept clearly separated and identifiable from any other TO activities which are funded through the prevailing RIIO price control arrangements.

5.61. We consider that it is possible that winning bidders may in the future be required to ringfence bidding teams if they become involved in network planning or bid assessment roles. This would depend on the winning bidder's size and number or positioning of assets, but is something Ofgem expects to consider in the future once the finalised arrangements have been implemented.

Views on the TO counterfactual approach

5.62. Our August consultation recognised 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 our consultation document, we referred to this proposed approach as the "TO counterfactual approach". In our consultation we noted that whilst in principle we understand the potential benefit of the aim of ensuring that consumers realise the most economically advantageous option for each investment in the network, in practice, we do not consider that the TO counterfactual approach would be able to deliver this. We additionally flagged that from a legal and regulatory perspective, it would be challenging to see how the TO counterfactual model could be developed in a manner that is clear, transparent, and fair. We welcomed respondents' thoughts on the TO counterfactual approach.

5.63. 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

[27] As explained in 6.3 TRS refers to the financing model proposed for projects subject to early competition.

existing price control arrangements as it would do currently- this includes having access to pre-construction funding for the development of projects.

5.64. 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 Ofgem assessment of each TO proposal 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.

5.65. 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.

Summary of consultation responses

5.66. Of those who responded to this question, the majority agreed with our views on the TO counterfactual approach, noting that this approach would not be transparent and would create an un-level playing field. Two respondents additionally highlighted the challenges and limitations of the approach under the current pathfinder arrangements, in which the TO provides a counterfactual solution in a similar process.

5.67. However, some respondents disagreed with our views. The respondents who disagreed (two TOs and one non-TO) noted that their preference was to participate in early competitions as a counterfactual, through the RIIO framework, and that it would be worthwhile developing the counterfactual approach further at this stage. The same two TO-respondents noted concerns over competitions failing and that the TO counterfactual approach would protect customers and provide a contingency option should a competition fail. They noted failure of the competition process could result in significant constraints costs to consumers and could also be detrimental to network maintenance. The two TO-respondents also noted concerns that TOs are better placed and have greater interest in considering longer-term factors in relation to developing the network and understand the risks of certain unproven proposals to security of supply. Factors which they say might not be appreciated by new market participants.

5.68. One respondent noted its view on the counterfactual and that the principal difference between the proposed counterfactual approach and TO bidding on the same basis as other bidders is principally in the timing: the bids would be after publication of need, and the counterfactual would be published with the publication of need. The respondent considered that the TO counterfactual approach is better, because it sets a baseline against which all bids are assessed, which will have additional beneficial results in (a) leading developers to avoid putting forward more-costly schemes and (b) giving an idea of the contract values that can be expected. Without (a), small developers are excluded.

Our conclusions

5.69. 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.

5.70. Having reviewed the responses to our consultation, we continue to consider that the TO counterfactual approach would not realistically be able to deliver the most economically advantageous options for investment in the network.

5.71. In our August consultation we highlighted our concerns surrounding this approach from a legal and regulatory perspective, noting that it would be challenging to make this fair and transparent. Also, noting that if the TO counterfactual approach were progressed, further consideration would be needed for any applicable procurement law. We did not receive sufficient evidence or supporting statements from respondents to address these concerns, we therefore continue to consider these to be serious and valid concerns with the TO counterfactual model.

5.72. One of our primary concerns with this approach, shared by the ESO, is that it appears to involve several 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 invest in the ITT process, meaning the TO is unlikely to face strong enough competition to give a true comparison between the competitive and monopoly TO approaches.

5.73. A key issue is that the comparison between the non-TO bid and the TO counterfactual would be taking place at an earlier stage in the development of options and would be comparing two different regulatory models with different risk profiles. With third-party bidders having to essentially lock-in costs at an earlier stage than the TO it

presents a key disadvantage to any non-TO bidders. We have not had sufficient supporting evidence or examples from TOs to assure us of how to mitigate or resolve this issue, nor have we received sufficient explanation of how these differences could be accounted for in a fair way when assessing the bids in competition. We therefore do not consider the TO counterfactual approach appropriate.

6. Chapter 6 – tender process and commercial model

Section summary

This Chapter summarises stakeholder views on the tender process and commercial model proposed by the ESO and how these arrangements will be taken forward.

Introduction

6.1. This Chapter covers the ESO's proposed commercial model that can be applied to the successful bidder and its proposed approach to the design and running of early competitions.

6.2. There remains significant work to be done to finalise further detail on the tender arrangements and detailed commercial model. We have concluded that the ESO is the most appropriate body to undertake the Procurement body role and so consider it will be best placed to complete the work needed to finalise the tender arrangements and detailed commercial model. For this reason, our consultation only provided our initial views, specifically focussing on the elements of the tender process and commercial model that are unique to early competition. This decision document outlines a summary of the key issues and responses we received from stakeholders.

The commercial model proposed by the ESO

6.3. Our August consultation explained that the ECP proposed a revenue model where bidders are expected to bid the revenue they would expect to receive for delivering and operating their project over the fixed duration specified within the competition. This is referred to as a Tender Revenue Stream (**TRS**). The ECP proposed that the duration of the TRS would 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.

6.4. Under the ECP proposals, bidders would be required to commit to margins and overheads on construction and operation of their project along with an underwritten equity commitment.

6.5. 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.

6.6. The key cost reopener referenced in the consultation was the ESO's proposed "Post Preliminary Work Cost Assessment" (**PPWCA**) process. Our consultation explained that process is intended to adjust the revenue of the successful bidder in a targeted way and if specific conditions are met. Only specific changes to the pre-determined costs of delivering the work as a result of the preliminary works are 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.

Summary of consultation responses

6.7. Two TO-respondents raised concerns with the commercial model, with the third TO stating that they agree broadly with the proposals although acknowledged that further detail is required to determine if the model will be successful. We received a varied response from non-TO-respondents, with most proposals agreed to in principle, but with some serious concerns raised. All respondents agreed that more work and detail is required to make a proper assessment of this model. These concerns are all explained in more detail below.

6.8. One TO-respondent held the view that the model is both overly complex and still requires a significant amount of work. They felt that the bid process may be perceived as too complicated by non-TOs, and this may deter potential bidders. They also stated that the high bid costs based on the model-requirements may also contribute to deterring potential bidders.

6.9. A TO-respondent had concerns regarding the TRS. They stated that other models should have been considered and worked examples should have been provided to support the decision to use TRS.

6.10. One TO-respondent agreed, in concept, with the proposal for a cap on PPWCA cost changes but disagreed with the proposals for how this should be set. They stated that arbitrary setting is not beneficial or appropriate for the wide range of bids and projects.

They proposed that the cap should be set relative to the performance bond but did not give further detail on how this would be achieved.

6.11. This same respondent also stated that they are concerned about the long-term effects on the network if bids are selected based on cost benefits only. They feel that this would mean there would be no incentive to think about how designs would impact the network beyond their asset life span.

6.12. Two respondents, one TO and one non-TO, noted specific concerns with the PPWCA process, with both welcoming guidance documents on the process, stating that these would be highly important for new bidders. One respondent raised concerns about the bidder cost of equity being set at the bidding stage, whilst the cost of debt is finalised following the PPWCA process. Their view is that setting them both at the PPWCA would deliver the most efficient financing for consumers, though recognised that this would limit comparability at the bid stage. They suggested that circumstantial changes such as changes in tax or inflation between the bid submission and the PPWCA would be priced into the cost of equity of the winning bidder unnecessarily. They suggested indexing aspects of the bids during this period, or sharing any financing changes between bid evaluation and PPWCA could help mitigate this risk. The second respondent felt that the preliminary works should be completed before the PB is chosen, adding that the outcome of the preliminary works could potentially change the ranking of bids. They further added that this impact on bids may also be legally challenged, adding further delay and complication.

6.13. One respondent raised concerns around the possibility for projects to be terminated at the end of the preliminary works stage. They noted that they believe this is too late in the process and could deter potential bidders, particularly as the consultation does not mention the commercial arrangements should a project be cancelled at this stage.

6.14. Two respondents raised concerns with the proposal around length of the TRS for assets. The first respondent felt that a 45-year revenue period could limit competitive tension in the funding markets and reduce the opportunity for innovative funding solutions. The second respondent stated that contracts should be set to the life of the asset, or long enough to amortise it. They added that contracts should be renewable solely against the counterfactual, not commercially tendered at the cheapest rates. They added that TRS should allow for refurbishment and upgrade costs so that they are treated equally to other grid assets.

6.15. A key concern of one respondent was the common cost of debt approach. They stated that they are not aware of any procuring bodies undertaking project financing using this approach, also noting concern with this approach as to whether the solution is bankable at the end of the procurement process. They also stated that successful bidders will have no incentive or competitive pressure to seek out innovative solutions to funding their solutions once they have already won the bidding rights.

Our conclusions

6.16. Our consultation recognised 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.

6.17. We remain comfortable in principle 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.

6.18. We recognise that respondents, particularly potential bidders, have raised concerns about the apparent complexity of the PPWCA process, and the extent to which it is compatible with ensuring that the most efficient financing approaches available can be utilised. Further work is to be undertaken by the ESO in developing the PPWCA process. We expect to share details and provide guidance on this process once these works have been completed.

6.19. We consider that the ESO, as the Procurement Body, will be best placed to finalise the arrangements to ensure that the final commercial model effectively balances appropriate protection from cost overruns for consumers, whilst ensuring that bidders are attracted to the model and appropriately protected from cost changes during the preliminary works stage that are outside of their control. We expect the ESO to work with all stakeholders to ensure that it fully understands the concerns raised, and fully considers them in determining the finalised commercial model. We remain committed to working with the ESO to help ensure that this balance is appropriately achieved.

Views on the Tender process proposed by the ESO

6.20. In our consultation, we summarised the ESO's ECP proposals at each of the following stages:

- **The pre-tender process**: this focuses on ensuring bidders will be able to develop their bids.
- **The pre-qualification (PQ) 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
- **ITT stage 1:** 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.
- **ITT stage 2:** 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 to the successful bidder.

Summary of consultation responses

6.21. Two TO-respondents raised concerns with the overall length of early competition processes. Both stated that early competition will add approximately 2-3 years onto the delivery process. They felt that planning and consenting should start as early as possible, and that these steps slow down progress, and ultimately impede our progress towards Net Zero.

6.22. One non-TO respondent highlighted concerns with the PQ stage. They stated that resource is usually spent inefficiently at PQ stages, as with their experience with bidding in the OFTO tender process. They propose PQ pre-approved passports, which would mean bidders wouldn't need to progress through the PQ stages each time they bid.

6.23. One of these respondents also had specific concerns with the PQ stage. They stated that the confirmation of the needs case can't take place until after the preliminary works have been completed, which in their view would be about 2 years later than under the RIIO model.

6.24. Another respondent raised concerns that bidders will not be able to assess how their proposals will score against the evaluation criteria. They say that this issue has arisen previously with the Pathfinders project, where the ESO did not publish

effectiveness factors. Their concern is that TOs will have access to the model and will also be bidding themselves, giving them an unfair advantage.

6.25. A respondent noted concerns with ITT stage one. They emphasised the importance of ensuring that this stage does not repeat anything from the PQ stage as this would waste time and resource. They also stated that the Pass or Fail assessment will not work unless all bidders that pass are able to progress to the next stage. They did agree however, that cost elements should not be scored at this stage.

6.26. Another respondent stated that they do not think the ITT stage one will add significant value in narrowing down potential bidders. They requested further details on relative scoring and transparent evaluation proposals. They also stated they have concern with the ESO's level of experience for handling assessments of this kind.

6.27. A TO-respondent stated that they are concerned with the prospects of bids being selected based on cost benefits alone. They feel that there is no incentive for winning bidders to have consideration of future concerns beyond the set period.

6.28. Another respondent stated that they are concerned the ITT stage 2 technical evaluation will be biased towards incumbent TOs. They also added that they don't understand the rationale for not having a Pass or Fail system for the technical evaluation.

6.29. This same respondent also raised concerns that bidders might game the tender process by submitting low bids, with a view to adjusting their costs at the PPWCA stage.

6.30. One TO-respondent stated that they do not agree that preliminary works should be completed after the PB has been selected. They suggested that without preliminary works there is no certainty on the scope of the solution, nor deliverability. Therefore, an accurate estimate of cost and timeframe is unlikely. The respondent also raised concerns over the number of bidders that will be approaching stakeholders such as councils. Their suggestion was this could be over-burdening or lead to stakeholder disengagement. They recommend that Ofgem and the ESO consult further with stakeholders before making a decision.

6.31. One TO-respondent raised concerns with the proposals for dealing with competition failure. They do not think that the OFTO "provider of last resort" is suitable for onshore assets. They requested detail on how a provider of last resort's revenue would be determined, and clarity of how TOs would be protected if they were the

provider of last resort. They added that Ofgem and the ESO must carefully consider the cost of delays following possible competition failure.

6.32. The same TO raised a further point of concern regarding new connections to the network. They stated that TOs have the best oversight for effectively connecting new customers to the network and they requested clarity on how the ESO or CATOs would achieve this.

Our conclusions

6.33. Having considered the responses to the consultation, we remain broadly comfortable with the tender process proposed in the ECP, whilst recognising that there remains work to be done to finalise an effective and transparent tender process.

6.34. In the next stage of the work, we expect the ESO to consider the points referenced by respondents, as well as any relevant feedback on the existing Pathfinder process, in finalising the early competition tender process. Specifically, we think it is important that bidders have as much transparency as possible upfront on how the two ITT stages will be assessed ahead of competitions being run.

6.35. We will work with the ESO to ensure that our assessment of whether an indicative solution in the network planning process remains in the interest of consumers is suitably aligned with the tender process to minimise the circumstances in which competitions are cancelled due to the need for the project falling away. In addition, we will look to further consider and consult on the optimal arrangements in the event of a competition failure.

7. Next steps

7.1. This decision confirms that the ESO should continue to develop the early model of competition. We expect it to develop the model that will be compatible with the decisions in this document on the criteria for identifying network needs that are suitable for early competition, and our specification of roles and responsibilities. It should also be in line with the findings of the ETNPR.

7.2. We will work with the ESO to ensure that the underlying model is supported through appropriate changes to existing ESO and TO licences. We will review and approve the final tender process, tender documentation, and commercial model ahead of the first competition.

7.3. 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[28], 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 any potential legislative changes introduced by the government, we expect that the Secretary of State will need to be empowered to be able to appoint the Procurement Body

7.4. In terms of the detailed development of the commercial model and the tender process, we consider that this is best progressed by the Procurement Body within the early competition model. Our decision is that this should be the ESO, which is being proposed to transition to the FSO. This is subject to decisions made on the FSO, and associated timings, which will be set out in the upcoming FSO consultation response.

[28] 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

Appendix 1 – Potential stages of the CSNP process Stage	Responsible Body	Key Aims/Actions	Key characteristics
1 - Model Future Supply and Demand	Central Network Planner	- Develop future energy demand and supply scenarios or estimates by scanning for future changes in demand/generation, in order to develop an optimised plan for necessary investment in the ET network and to identify Strategic Investments (SI).	- Estimates to adhere to principles such as being developed transparently, with stakeholder input and be plausible. - Could be modelled mechanistically or through strategic assumptions. - Nearer and longer-term estimates could be derived differently, depending on levels of clarity.
2 - Identify System Need	Central Network Planner	- Analyse power system based on demand / generation estimates from Stage 1, to identify all network issues. - Investigate if network issues require intervention on the ET system, or if opportunities exist to efficiently shape energy system. - Identify issues that are critical to delivering Net Zero or other key targets, and would need SI.	- Network assessments to include all power system studies and operability assessments, and shouldn't be limited to identifying thermal constraints on NETS boundaries.
3 - Identify Investment Options	Central Network Planner and TOs / Third Parties	- Identify options to meet ET network needs. This could include SI or non-SI in the ET network, or wider strategic energy system solutions. - Identify multiple potential solutions for each issue, also considering options that resolve multiple issues. - Assess technical robustness and of robustness of key assumptions (eg cost and EISD)	- Non-SI options to be identified by TOs or third parties, e.g. through early competition. Central network planner to ensure that these address system needs and align with the overall CSNP. - High level design for SI options to be specified by central network planner. - Central network planner to get strong support from TOs and third parties in developing options to ensure feasible and deliverable options are developed. - High level environmental/community impact assessment, and site and route assessment to be carried out by central network planner.
4 - Cost Benefit Analysis	Central Network Planner	- Carry out an appraisal of the technical and economic aspects of each option (for SI and non-SI), using robust methodology including CBA, to make decisions about which options are preferred and should be progressed via the CSNP.	- CBA to include quantitative and qualitative factors including environmental and community impact.

Feedback loop between stages 1 to 4

		- Undertake CBA to determine any preferred wider energy system options.	
5 - Develop CSNP	Central Network Planner	- Develop an optimised Centralised Strategic Network Plan comprising of SI, non-SI and energy system design options finalised in earlier stages.	
6 - CSNP Finalisation and Handover to Delivery Bodies	Central Network Planner and Ofgem	- Preferred options in the CSNP go through relevant regulatory approval process. - Make recommendations on strategic energy system solutions to Government/Ofgem. - Handover to relevant delivery body (TO or third party)	
7 - Detailed Solution Design	Delivery Body (TOs / Third Parties)	- Carry out site surveys and route assessment. - Carry out environmental and community impact assessment. - Assess requirements for planning consent and land rights. - Produce layout drawings and establish functional specifications.	