

RIIOElectricityTransmission@ofgem.gov.uk

15 September 2022

Dear RIIO Team,

### **Accelerating onshore electricity transmission investment**

Transmission Investment, as one of the UK's leading independent transmission companies manages one of the largest offshore electricity transmission portfolios. We are a strong advocate of introducing competition into the delivery of transmission and we continue to support the development of the required arrangements *inter alia* through industry groups, responding to consultations such as these and providing evidence to Parliament.

Transmission Investment is also leading, in partnership with the French national grid company RTE, the development of a proposed 1400MW HVDC interconnector between France and Britain via Alderney ("the FAB interconnector project") and is also developing alone a 700MW HVDC interconnector between Scotland and Northern Ireland ("the LirlC interconnector").

**We cannot support the proposed exemption of projects considered suitable for competition.** The consultation document has not provided evidence that delays would result from competition. Nor have the criteria for exemption been met for the 16 projects identified as suitable for competition.

While the overall benefits case is finely balanced in support of Ofgem's proposals, the exemption criteria are set on a project basis. In the absence of the project-by-project analysis identified in paragraph 4.13, there is insufficient evidence as to whether each project meets the criteria set out for granting an exemption from competition.

The consultation also does not consider the long-term impacts on market attractiveness that would result from the proposed exemptions. This is in terms of both reducing the available pipeline of projects for network competition and the supply chain advantages gained by the incumbent TOs when those competitions do start.

Further to that, the estimation of the net benefits (even the optimistic case) is small compared to cost uncertainties that Ofgem has not considered, despite its own observations on past projects.

**Learning from past reviews of accelerated delivery of large infrastructure programmes needs to be considered in Ofgem's cost-benefit analysis.** A relevant example is the delivery of the Milford Haven pipeline, where costs escalated substantially. That project was not competed, had full upfront funding available, however, costs escalated by around 25%. Ofgem's review concluded it was due to a range of factors both within and outside of the control of National Grid<sup>1</sup>, but highlighted questionable choices around route, design and contracting strategy, suggesting engaging more organisations would have lowered costs, "*if the workload was spread more widely and delivered by more contractors, then costs may have been lower*". Ofgem's consultation proposals here, appear to further concentrate, rather than spread the work more widely.

Therefore even with the best view of benefits, consumers are at a real risk of a disbenefit in the pursuit of the 2030 targets where project costs rise by just 10%.

Ofgem identifies two drivers for accelerating delivery, i) expected changes to the planning system and ii) reducing the regulatory scrutiny. Other than enabling the TO to begin pre-construction

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<sup>1</sup>[https://www.ofgem.gov.uk/sites/default/files/docs/151202\\_-\\_mh\\_ex-post\\_review\\_decision\\_letter\\_03\\_december\\_2015\\_rev\\_0.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/151202_-_mh_ex-post_review_decision_letter_03_december_2015_rev_0.pdf)

works earlier, there is little clarity provided on what the TOs are committing to do differently that will lead to accelerated delivery. No independent analysis is provided to support the assertions made: that competition will cause delay; or early engagement with the supply chain on these projects will lead to substantive shortening of the achievable delivery schedule.

**We support the intent of seeking to streamline regulation to accelerate delivery of infrastructure.** We believe that competition for onshore projects can support this intent, and Ofgem's proposals may better facilitate the use of Late CATO Competition. We also note Ofgem's statement that, *"We do not consider that there is any evidence to suggest that third-party delivery of strategic projects through onshore competition would take any longer to deliver than TO delivery."*

**If providing the TOs with earlier certainty of funding to undertake pre-construction works will accelerate these, this will better facilitate Late CATO competitions.** The scale, discreteness, and project-by-project incentives leads to separate contracting of these projects being the natural solution. This is necessary to allow the specific risks to be backed-off into the supply chain. This provides the ideal opportunity for applying a Late CATO competition model, recognising that this may not work for projects delivering earlier than 2028, due to the timeline for the legislative process. The potential to use a competition for 2030 and 2031 projects should be kept open. We therefore believe that with earlier funding and delivery of pre-construction works, the opportunity for competition remains open for both the 10 projects that need to be delivered before EISD/by 2030 and the six projects with 2030 EISDs.

**The effect of these proposals is to move risks to the consumer,** which are normally borne by the TOs. This appears to be contrary to Ofgem policy of allocating risk to those best able to manage it. We agree with Ofgem that further protection for consumers would be needed to counter this and to mitigate the reduced regulatory scrutiny.

**The incentive package needs careful calibration and added protections to ensure TO choices and consumer interests are fully aligned.** While the overall package provides the incentive to: get on, spend what you need, and deliver on time (or earlier); we highlight two examples of areas that should be considered further. First, the Output Delivery Incentive appears to be sized such that any penalty could be passed straight onto the supply chain, e.g. in the form of liquidated damages, for non-delivery. Second, there is an interaction between the Totex incentive exposure and Output Delivery Incentive, where it may be possible that a TO benefits from overspending to reduce the ODI penalty, but it results in an overall net disbenefit to consumers, due to the different incentive rates.

Overall, the proposal to give the TO's the right to deliver the majority of the infrastructure to 2030, must come with meaningful consequences if they subsequently fail to deliver for consumers. Prior examples of building infrastructure at unprecedented scale and pace provides key learnings applicable to creating this accelerated delivery framework. Persistent and repeated delays in the introduction (for over a decade) and restricting and now exempting the use of competitive approaches, risks undermining the interest in this market. The consequence will see consumers face further disbenefit, beyond those analysed within the consultation document.

Yours faithfully,



**Mark Fitch**  
Corporate Development and Regulation Manager

## ATTACHMENT – RESPONSE TO SPECIFIC QUESTIONS

### **Q1: Do you agree with our criteria for identifying projects in scope for the application of the proposed accelerated delivery framework?**

Yes. Assuming that “clear evidence” means the benefits are substantially higher than the potential detriment and therefore, consumers are more likely, than not, to receive a net benefit.

### **Q2: Are the 26 projects identified the correct ones to initially focus on?**

The process used to filter the projects down appears to be logical as it identifies those potentially suitable for competition as the baseline from which to consider exemption.

It is impossible to judge if there are other projects that should be brought forward to meet the 2030 needs.

### **Q3: Do you agree that it is in the consumer interest to consider exempting projects from competition?**

We agree to considering an exemption where there is clear, independent analysis of the risk of delay to the in-service date from a Late CATO delivery. The consultation provides no independent analysis that there would be a delay, in fact Ofgem propose the opposite: “*We do not consider that there is any evidence to suggest that third-party delivery of strategic projects through onshore competition would take any longer to deliver than TO delivery.*” We would expect any exemption decision to be based on analysis that demonstrates the likely delay, when compared to a realistic risk-adjusted counterfactual (i.e. recognising the impact of an unprecedented delivery programme). Any decision to give an exemption must be grounded on independent analysis that shows a clear and significant likelihood of a material benefit to consumers of avoiding that delay. The consultation document does show that, if the asserted delays did occur, the consumer interest is finely balanced, based on the developers delivering all of the 50GW of generation projects on time.

The analysis does not appear to consider factors such as: the 50GW of projects may not all be delivered on time, and costs of delay therefore reduced; or wider consumer disbenefits, e.g. the reduction in competitive tension for these projects now, and for future projects, (due to fading bidder interest as competitions continue to be delayed).

Ofgem does have the opportunity to refine its consultation proposals to avoid many of the disbenefits. For example, incentivising the TOs to use greater upfront funding to deliver the pre-construction works in a way that is most suitable for a Late CATO process. This is especially the case where projects have yet to be started by the TO and therefore there would be no existing supply chain engagement or expectation.

If the accelerated framework is reshaped to incentivise use of the Late CATO process, consumers then see the benefit of competition, and the benefit from a broader supply base. This would help to mitigate a key risk identified from Ofgem’s review of the Milford Haven project. In that review, Ofgem identified that supply concentration (where the need for more supply chain capacity was not identified or was not acted upon) was a factor that led to cost overruns for the Milford Haven pipeline project.

If a decision to exempt a project is made, consumer interests must continue to be protected using mitigation measures to compensate consumers for any failure to deliver.

#### **Q4: Which of our options for exempting projects from competition do you favour?**

The way in which the Options are described appears to be prejudging the analysis to be undertaken by the ESO, and it is not clear how they would differ in practice.

In the absence of the detailed project-by-project analysis there is insufficient evidence to decide if each project fulfils the criteria for exemption as set out in paragraph 3.5 of the consultation document.

Our interpretation of the difference between the Options is only in the presumption of treatment of the 6 projects with 2030 EISDs, as in both Options the decision can only be made on the evidence of the detailed project-by-project analysis.

- Option 1, exempts the projects from competition, subject to detailed project-by-project analysis overturning that position; while
- Option 2 does not exempt them from competition, however, in Table 14 the comment relating to these 6 projects says “Not yet exempt from consideration for competition”, the “yet” implying there is further analysis to be done.

This in practical terms makes the two proposed options identical.

On the basis that Option 2 presumes competition for at least 6 projects, it would be our preferred option. We also understand that Ofgem’s proposal is that the remaining 10 projects (that need to be delivered before EISD and by 2030), would be opened to competition where the detailed analysis showed they failed to offer clear benefit from exemption or evidence of a delay. The likelihood of delay and benefits must be assessed independently of the TOs and consider realistic expectations of how much of the 50GW will be delivered on time. Otherwise consumers will face higher than necessary infrastructure costs, to avoid system constraint costs that never appear.

In practical terms Option 2 sees the 16 projects progress to detailed analysis, unless they fall into the category that they must start too soon for a competition to be run. The case for exemption for each of the 16 projects, especially those that have not started, need to be analysed to establish the likelihood of delay and clear benefits for consumers, before Ofgem can conclude if they meet the exemption criteria. The analysis should be done with full recognition that a key feature of the accelerated delivery framework is to allow more flexible and earlier upfront funding for pre-construction works. This should accelerate the delivery programmes, bringing projects to the point which they could be competed earlier, better facilitating the use of a Late CATO process.

If accelerating the pre-construction works is not the intended effect of earlier and more flexible funding, it will be important for Ofgem to outline to stakeholders what they perceive as the activities TOs are expected to do differently under this accelerated investment framework.

We have annotated Table 13 from the consultation document to summarise what we understand to be Option 2 (in the first row, orange shading and text).

**Table 13: Categorisation of projects considered for expedited delivery in our CBA analysis.**

<i>Our understanding of OPTION 2</i>	<i>Exempt from competition</i>		<i>Subject to competition</i>		<i>Detailed analysis to decide on a net-benefit basis Noting those that have not started should be planned to align to Late CATO</i>	
	Projects that do not meet the criteria	Projects that need to start too soon for competition	2030 projects (6 total)		Projects that need to be delivered earlier (10 total)	
			Started	Not started	Started	Not started
	EDEU	BTNO	AENC	BBNC	TKUP	CGNC
	DWNO	E2DC	ATNC	SCD1	BPNC	EDN2
	HWUP	E4D3	SLU4	PSDC	E4L5	GWNC
	PTNO	OPN2			TGDC	BLN4
	TKRE	PTC1				LRN4
						PSNC
<b>Sum of Capex</b>	£0.73bn	£4.1bn	£1.5bn	£2.8bn	£5.2bn	£5.5bn

**Q5: Do you agree that without upfront certainty that they will be delivering enough of the investment needed for 2030, TOs will face significant difficulties mobilising the supply chain to deliver the works on time?**

There is insufficient evidence provided of what specific difficulties the TO are suggesting they face mobilising the supply chain. Ofgem's proposals keep a two-step approval process, splitting costs between pre-planning and (LOTI style Final Project Assessment) post- planning consent. This break point means the supply chain cannot know with certainty how projects will progress – which means there is a natural point that would allow the Late CATO model to be applied.

Therefore, it is not clear from the consultation how providing the TOs with upfront funding increases certainty to the supply chain, beyond that which already comes from the publication of the specific projects that make up the Holistic Network Design.

Ofgem's consultation is not clear on what the consumer is paying upfront for, how preliminary works costs will be tracked and allocated between projects and how it links to the tangible benefits e.g. earlier than EISD delivery. If the TOs are able to accelerate pre-construction works to give the supply chain earlier certainty on projects, this would equally allow the Late CATO tender model to be applied for those projects.

**Q6: Do you agree that it is in consumer interest to consider streamlining our regulatory processes?**

Yes, where it allows for funding for earlier completion of pre-construction works to enable the Late CATO process for all of the 16 projects under consideration.

**Q7: Which of our options for streamlining our regulatory processes do you favour?**

Approach 2 is our preferred approach. It is the most appropriate as it commits consumers only to the pre-construction works and provides a natural break point for Late CATO to be introduced where the analysis demonstrates no clear benefit to exempt a project, e.g. they have not yet started.

Approach 1 acceptance of the needs case appears to be a logical step. This is valid where the ESO has independently assessed the needs case. It is a natural outcome of the Holistic Network Design process, and similarly should emerge from the future Centralised Strategic Network Plan (assuming there is a comprehensive suite of solutions and options considered).

Approach 3 appears equivalent to the process proposed to be applied for Early Competition CATO. This would commit the CATO bidder to costs at time of bidding, subject to limited adjustment through the Post Preliminary Work Cost Assessment. The existence of a competitive tension around this end-to-end process will reduce the ability of any party to build excessive contingency into the cost profile, at risk of losing out to a competitor. This tension is not available where the TO's maintains a monopoly and retains an information advantage, therefore would be less appropriate.

We do not support the other Approaches.

**Q8: Do you agree with the costs and benefits methodology we have established?**

We believe Ofgem have overlooked the potential cost increases from delivering an accelerated programme through a concentrated number of lead organisations. Past experience of when infrastructure has been delivered at unprecedented pace, has shown that this tends to narrow the supplier base and was a clear factor in increasing costs above what they could have been. In Ofgem's review of the Milford Haven project it noted that broadening the supply base would have reduced the resource pressures and lowered the cost for consumers. This learning should be considered in the analysis here as an additional detriment to consumers.

The continued deferral and restriction of the application of competitive processes is having a chilling effect. The proposal to exempt the majority of the known pipeline of competition-suitable projects is reducing credibility with potential investors that this is a market into which they will be able to deploy capital within a foreseeable timeframe. The effect of narrowing the supply base at the beginning of this unprecedented-scale programme will have a lasting impact. Incumbent TOs will have exclusive opportunities to gain experience of these projects and undoubtedly build further influence on the supply chain, with consumers losing out on the well understood effects of greater competition, including efficiency and innovation.

**Q9: Do you agree with the conclusions of our cost and benefits analysis?**

While the collective analysis provides a useful indication of the potential cost and benefits, it does not provide the necessary clear evidence of net benefit for individual projects to support an exemption decision by the Authority based on the proposed criteria.

The additional analysis outlined in paragraph 4.13, adjusted for our concerns e.g. likely delay, missing detriment of a concentrated supply chain; realistic outlook on constraint costs factoring in uncertainty that the 50GW of generation will arrive on schedule; and longer-term competition impacts needs to be completed before the Authority can make a decision.

**Q10: What are your views on introducing a package of regulatory measures which Ofgem may apply to protect consumers?**

We agree measures to protect consumers are essential. Where the TO's are avoiding competition and being handed the right to deliver these projects, there must be a strong obligation on them to deliver on time.

The package of regulatory measures needs to provide a coherent incentive to encourage delivery of these obligations. The incentives should mitigate the loss to the consumer, where the TO actions do not accelerate delivery or meet the agreed dates.

**Q11: What are your views on the design of each of the regulatory measures? (Please clearly reference which measure(s) your comments relate to e.g. Accelerated delivery Output Delivery Incentive, Ex post efficiency review, etc)**

The consequences of projects not being delivered are significant for consumers. A formal Licence obligation that is enforceable as a licence breach provides a strong signal to the organisations being given the right to deliver this infrastructure. Using a mechanism to adjust the funding for undelivered projects (under a Price Control Deliverable) does not appear to be proportionate given the significance of the potential impact on consumers, especially at this time of a cost-of-living crisis.

The calibration and detail of the application of the package of incentives will be key to achieving an alignment of the TOs decisions and consumer benefits. Using a simple example, the TO incentive to avoid an ODI penalty could be distorted by its exposure to Totex overspend. For example, with a 15% Totex sharing factor the TO could be prepared to overspend £100M to avoid a delay that has a £31M impact on balancing costs. The TO would bear £15M under the Totex incentive, but gain £15.5M under the ODI regime (50% of the impact) netting a £0.5M benefit for accelerated delivery. From the customer perspective, however, they bear Totex overspend of £85M for a £15.5M constraint cost saving, and therefore would face ~£70M detriment.

We support the use of an ex-post efficiency review as a feature of the accelerated regime. It is a useful tool to drive effective management control, so that decisions are appropriately balanced between spending money and the impact on delivery. Such reviews must be taken with a view of the information available at the time. An ex-post review mechanism is a backstop safeguard for consumers, for example: against the consequences of unintended incentive outcomes; and provides a mechanism to assure cost allocations between activities. It should be used proportionately to ensure consumers are protected and can be confident they are getting value-for-money for each project.

**Q12: Do you think our proposals raise any financeability concerns or create excessive financial risk for the network companies? If so, how could they be addressed?**

No. The reopeners and RAM provides adequate protection to ensure financeability.

**Q13: Is any further guidance, or additional specific information, needed as part of the TOs' project delivery plans?**

The TOs need to provide accelerated pre-construction works programmes for all potentially non-exempt projects, including how those plans will enable the use of the Late CATO tender process (should legislation allow).

This should demonstrate how the newly given regulatory freedoms contribute to accelerated pre-construction works and the delivery of a workable programme timeline with the tender process for CATO included.

TO's should be rewarded for successfully enabling CATOs, including allowing recovery of efficient incremental costs they incur.

**Q14: Are there any additional timetable issues that need to be considered?**

No comments