

FAO: Jane Dennett-Thorpe/ Gavin Knott

By email: FutureNetworkRegulation@ofgem.gov.uk

19 May 2023

Dear Jane and Gavin,

Consultation on frameworks for future systems and network regulation: enabling an energy system for the future

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.

The lack of sufficient pace in the delivery of network infrastructure is a barrier that continues to grow, year-by-year¹, leading to wasted money and higher costs to deliver Net Zero, because energy projects cannot be used to their full potential. The network monopolies, given three decades head-start to create the nation's infrastructure, have failed to grasp the unique opportunity to step up for the consumer at this key time.

While RIIO regulation has delivered significant benefits, the growing complex formulae and deep scrutiny of the monopoly businesses has resulted in the focus being on the regulatory settlement, rather than consumer interest.

Commentators are of the view, and evidence is mounting, that what we have is not fit for the energy transition. The incumbent monopoly businesses have been in the spotlight, whether in the Financial Times² or BBC³ for reportedly holding back economic growth due to connection delays, poor response to storms, or questionable approaches to asset management decisions⁴. It is broadly accepted that by introducing competition, quality will go up and prices down.

Previous examples where there has been a need to accelerate delivery of large infrastructure programmes e.g. the delivery of the Milford Haven project, saw costs escalate substantially by around 25%. Ofgem's review concluded it was due to a range of factors both within and outside of the control of National Grid⁵, 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*". Demonstrating the risk of concentrating delivery in the hands of only a few organisations.

¹<https://www.current-news.co.uk/news/current-price-watch-wind-curtailement-reaches-record-highs-as-national-grid-eso-issues-winter-warning>

² <https://www.ft.com/content/519f701f-6a05-4cf4-bc46-22cf10c7c2c0>

³ <https://www.bbc.co.uk/news/science-environment-65500339>

⁴[Dinorwig-Pentir FNC](#)

⁵https://www.ofgem.gov.uk/sites/default/files/docs/151202_-_mh_ex-post_review_decision_letter_03_december_2015_rev._0.pdf

More recently Ofgem identified three important shortcomings of incumbent delivery: how it has managed the asset; in its optioneering (to the point of needing to instruct alternatives to be considered); and in its early decision to close-down alternatives (by appointing a contractor) ahead of project confirmation. Ofgem have concluded through the analysis that there is no alternative than to continue with the incumbent delivery and therefore is asking consumers to simply accept these shortcomings.

Consumers have been let down by the slow development of the regulatory system, with Accelerating Onshore Electricity Transmission Investment (“ASTI”) allowing further concentration to the incumbent onshore network of the large-scale infrastructure to 2030.

We fully support the objective within the ASTI policy to simplify regulation as a way to increase the pace of and incentivise on-time delivery. These are natural features of the proposed competition regime, where a direct reduction in revenue (and consequential reduction in returns) provides an compelling incentive to manage the project to avoid any delay.

National Grid also highlights, in the recent report⁶ “Delivering for 2035”, introducing competition is a key action and acknowledge that competition will be effective in driving down costs and improving innovation, beyond the level that regulation has, or can.

With the Energy Bill legislation moving towards Royal Assent, this review of the framework is timely. It is a critical opportunity to fully unlock the possibilities of competition to broaden the market for delivering our onshore network infrastructure. It seems appropriate to bring new parties in as the need for infrastructure continues to increase in volume, innovation is required to address challenging changes in the system and to lower the costs of new infrastructure.

As such we would highlight the following key principles for designing the future framework:

1. Maximise the Plan and Deliver approach for delivering our network infrastructure.
2. Apply competition widely to reduce the power of information asymmetry and drive least cost, greatest value outcomes for consumers.
3. Adopt a long-term view of competition, recognising the value to consumers of revealing cost and performance insight.
4. Apply the simplest form of regulation that align the company to those interests, e.g. the OFTO regime which aligns to long-term interests of the user.

We address specific consultation questions in the attachment.

Yours faithfully,



Mark Fitch
Corporate Development Director

⁶ <https://www.nationalgrid.com/document/149496/download>

Q.2. How detailed could an independent, cross vector view become to determine future plans for periods beyond RIIO-2 and support effective use of the ‘Plan and Deliver’ model?

Plans developed for this purpose need to outline the system need, within the context of an overall architecture and development strategy for a region or whole system. In general, the plan should avoid detailed prescription, allow the widest possible range of solutions to be applicable to meet each need and take a long-term view of investment need.

Q.3. Under what circumstances would competition, or other procurement models such as open book contracting, have benefits over ex ante incentives as a cost control mechanism?

The tension between the duty on the regulator to allow the licensees to finance their functions and the information advantage held by the companies, means that competition must be applied to the broadest range of circumstances possible to reduce the power of information asymmetry.

Using competition effectively will reveal information over time that creates significant consumer benefit directly, and indirectly by providing benchmarks to test non-competed activities.

Competition should be applied as the default mechanism. We would advocate adopting a position similar to Ofwat for Direct Procurement for Customers. There the use of competition is a default and recognises that going through the process itself has significant value to consumers - *“For PR24 DPC will apply by default for all discrete projects above a size threshold... We would not treat a negative VfM estimate in the early stages as a reason not to proceed with DPC.”*

This supports a reset of the philosophy around the use of competition. In this case, moving away from seeking to judge at the outset the net-benefit to consumers on each project, but to explore the likely outcome through the process. Only stopping the process when there is robust evidence of no scenario where there is likely to be a consumer benefit (avoiding using an average over a range of scenarios – the average outcome being something which cannot occur in reality). We would also advocate avoiding distorting the cost-benefit by applying the first-of-a-kind costs of competition to the early first tender(s).

Q.4. What is your view on the options identified for simplification of incentive regulation? What would be the benefits and costs by comparison to the approaches used in RIIO-2?

We would highlight the example of the OFTO regime, which is simple and has proved highly effective. It is consistently delivering high availability and has seen significant savings for the consumer as referenced in BEIS economic regulation policy paper: “The regime has proved a success and has brought estimated savings for consumers in excess of £800 million since 2009” - based on CEPA’s 2015 report covering only Tender Rounds one to three⁷.

Q.6. What are the benefits and costs of this approach for Electricity Transmission by comparison to an evolution of the approach in RIIO-2, and what are the implementation barriers?

The activities of the RIIO businesses have been subject to effective disaggregation by the gradual introduction of a complex array of point-incentives to deal with a range of issues that arise at each price control review. These include for example, Opex escalators, Civils reopeners, Medium Sized Investment Projects, Large Onshore Transmission Investments, all of which have differing

⁷ <https://www.ofgem.gov.uk/publications/evaluation-of-to-tender-round-2-and-3-benefits>

boundaries and rules. There have been cases where overlaps and gaps have been identified, requiring detailed examination of allowance and cost assessment to align correctly to specific instances. Such complex arrangements run the risk of over or under funding companies for activities.

A simpler design of regime based on explicit disaggregation of core activities of the business could provide: greater clarity on cost of service, more easily identifiable performance and would provide further opportunities for Ofgem to apply competitive tension for individual segments, e.g. maintenance and refurbishment activities.

The simplifications under ASTI are welcome, with less detailed regulatory processes and direct incentives, which may have features that could be usefully transferred into an enduring competitive regime.

Q.10. Would there need to be any changes to maintain a stable and consistent financial framework if we were to make greater use of different regulatory archetypes, and if so, what would those changes need to be?

Setting the cost of capital allowance within the price control process to achieve acceptable financeability, as with all other cost elements, is subject to information asymmetry between the authority and company.

Information revelation has occurred in the OFTO tenders, where it has been found that the cost of capital for a single offshore transmission link, post-construction, is in fact lower than the allowed cost of capital for the aggregate activities of a licensed onshore transmission company.

While some inputs into the calculation are observable e.g. benchmark cost of debt or total market return, the specific cost of capital, gearing or debt terms etc for an activity or investment is unknown unless separately competed.

We make no comment on Q1, 5, 6, 7, 8, 9, or 11.