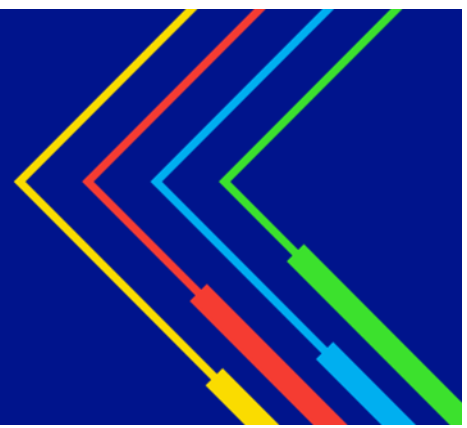


Consultation on policy updates to Early Competition in onshore electricity transmission networks

National Grid plc response



This response to Ofgem’s “Consultation on policy updates to Early Competition in onshore electricity transmission networks” dated 21 February 2024 (the consultation) is from National Grid plc (NG), on behalf of our transmission business, National Grid Electricity Transmission plc (NGET), our electricity interconnector business, National Grid Ventures (NGV) and our electricity distribution business, National Grid Electricity Distribution (NGED). It does not cover the separate National Grid Electricity System Operator (ESO) business.

We are pleased to see the recent updates on Early Competition Implementation (EC-I) from National Grid Electricity System Operator (ESO), and the details on some of the outstanding policy considerations from Ofgem in this consultation. The wider landscape has shifted significantly since the concept of early competition was first considered for onshore transmission networks and we welcome the adjustments made to the early competition regime to reflect this. It should, however, also be recognised that the landscape continues to develop, for example the precise scope and outputs of the Centralised Strategic Network Plan (CSNP) and the methodology for the CSNP are not yet known. The exact relationship between early competition and the CSNP therefore cannot be fixed at this stage. As such, we support the recognition that the early competition framework will need to evolve as we learn from implementation and gain further understanding on the interactions with other aspects of the wider framework such as the CSNP, REMA and SSEP. We consider the priority should be for Ofgem and the ESO to use the pilot tender to test the process, learn lessons and then on this basis to refine the process and design of the regulatory framework. We are committed to working with Ofgem and the ESO to do this based on experiences both within, and outside, of competitive tenders.

We support early competition where it will deliver benefits to consumers. This reflects the position in the recently published Transmission Acceleration Action Plan that recognises while many projects in the transitional Centralised Strategic National Plan (tCSNP) could be eligible for competition, the majority will likely need to be exempted in order to achieve delivery dates of 2035. This is a complex policy and regulatory change, and we encourage Ofgem to prioritise using the competition pilots as a practical way to develop and refine the new regulatory framework, rather than seeking to lock down every element of the enduring framework now.

We look forward to continued engagement with the ESO and Ofgem on the details of early competition implementation and stand ready to support the first tender later this year, as required.

This response focusses on the introduction of competition for transmission networks.

Key points:

- The benefits to consumers of the Competitively Appointed Transmission Owner (CATO) regime will be maximised by creating a framework which maximises the potential for organisations to participate in competitions. This critical success factor should be used to guide Ofgem decisions around the design of the regulatory framework to ensure a proportionate approach is taken which maximises consumer benefits. We have used this success factor to guide how we have considered the questions posed by Ofgem and our responses to this consultation.
- The consultation raises a number of complex policy and regulatory issues. As a novel approach, we consider Ofgem should focus on the decisions which are necessary to support pilot competitions by the end of 2024 and use the experience and lessons from these to finalise the future CATO regime, rather than seeking to lock in the full design of the regime now. We consider this evidence-based approach would help better design a regime which maximises the benefits of competition for consumers.
- We welcome the commitment to continue to refine the CBA methodology, learning from the pilot process, and refining the benchmarks and data used as more projects progress through the competitive process. However, we still have concerns that the CBA as it stands will not identify projects effectively that will deliver benefits to consumers through competition. Much of our earlier feedback to the CBA consultation is not reflected in the updated methodology and we have further concerns with some of the assumptions and approaches. We believe that the best way to move forward is for Ofgem and the ESO to commit to updating the methodology in light of

testing the process and conducting a lessons-learned exercise after the competition tender to identify where additional information and revised benchmarks can help with future assessments. For competition to be successful the market will need to have confidence in the process - as such, we believe that even where a competitive process reveals a higher market price than the counterfactual, this should be honoured.

- We welcome the additional detail provided on the CATO Of Last Resort (OLR) approach included in the consultation and are pleased to see that this mechanism is only expected to be used after all other avenues have been exhausted. Taking on a project unexpectedly will have an impact on the delivery of the project in question as well as the wider portfolio of the TO or CATO appointed. We would welcome confirmation from Ofgem that the terms on which a project would be transferred would be agreed by Ofgem and the CATO OLR ahead of transfer, and that these will be adapted as necessary to reflect the risk profile of the project and the delivery ambition (with the implication that additional allowances would be required to enable successful delivery). While the consultation does give some additional detail, we would appreciate further clarity on whether it will be mandatory for TOs to take on projects in certain circumstances, the route to obtain allowances to deliver projects, how this would be achieved under the RIIO framework, and how the associated risks would be taken into account.
- Given the critical success factor that competition will deliver the most benefits to consumers where there is a wide field of organisations (with the right skills and knowledge) participating, the conflict of interest provisions need to be designed in a way that still allows TOs to participate. Given the main conflict of interest for TOs has been eliminated through alignment with the CSNP (noting that the precise scope and outputs of the CSNP are still to be determined as the ESO develops the methodology), we consider a more proportionate approach to managing remaining perceived conflicts than the one set out in the consultation, is needed. In particular, the proposals to restrict the transfer of staff between the bidding unit and TO business for the duration of a tender process will be inefficient and costly, ultimately impacting the benefits that can be delivered through competition and potentially limiting the pool of bidders. Rather than restricting employee movements, we can manage potential conflicts of interest of transfers via a checklist for Onshore Competition, for example, and have significant experience of doing so.
- We agree with the principles that Ofgem is seeking to implement through company structure including demonstration of accurate debt pricing, the ability to ringfence and transfer assets, and the absence of cross subsidies. We believe that these principles can be achieved through either a Special Purpose Vehicle (SPV) or corporate structure. We have controls in place to prevent cross subsidies and there is a licence condition preventing cross subsidies which should carry a level of trust that a TO will not act in breach of its licence. As such, we do not believe that the SPV approach should be mandated so that bidders can choose the route most appropriate for them and to ensure that the bidding pool is as wide as possible. This is also consistent with the success factor of enabling the maximum participation in competitions – there is a risk that by mandating an SPV approach, TOs may choose not to participate due to the additional organisational complexities and costs. At National Grid we have successfully managed conflict of interest risk between our operating businesses for several years and do not see the need for more prescriptive arrangements for early competition.

Below are our responses to the specific questions posed in the consultation. We would be happy to discuss these in more detail and look forward to further engagement in implementing the early competition framework.

Q1. Do you agree that the proposed amendments by the ESO represent good value for money for consumers?

Overall, we agree that the amendments should help to facilitate timely and efficient competitive processes for both network and non-network solutions, thereby maximising the potential benefit to consumers.

Q2. Do you agree with the ESO's proposal of alignment of Early Competition with the Centralised Strategic Network Plan (CSNP)?

As noted above, the delivery landscape has shifted significantly since early competition for onshore networks was first considered and we agree that early competition and CSNP arrangements must be fully aligned and complementary. However, the precise scope and outputs the CSNP will provide are still to be confirmed as the ESO develops the CSNP methodology, in consultation with TOs and industry stakeholders. This uncertainty is one of the reasons why we support using the pilots to scope the future CATO regulatory framework rather than lock down the framework now while there is still uncertainty on how centralised strategic network planning will work in practice.

We agree that the technical specification for the competitive tender should be aligned with the strategic option identified through the CSNP. We note that the ESO EC-I update and the Ofgem consultation refer to connection points, study areas and corridors, but the level of detail that will be reflected in the strategic options identified in the CSNP is still to be confirmed as the CSNP methodology is developed. Defining exactly what level of detail will be included in the CSNP, what detail will be taken from the CSNP in terms of solution design for the competitive tender, and what will be for bidders to determine will be essential to facilitating the competitive process and should be considered further as the CSNP methodology is developed. While using the CSNP outputs may limit the scope for innovation for the preferred bidder in terms of the solution, we note that Ofgem's decision on the CSNP expects third parties to be invited to put forward solutions to identified needs as part of the CSNP process, and therefore expect that consideration of various solutions and designs will be made as part of CSNP development. To ensure that this is the case, further clarity is needed as the CSNP methodology is developed, regarding governance around the process for developing the CSNP recommendations and the TOs' role within that. If the CSNP includes appropriate optioneering and environmental assessments, allowing it to be endorsed in planning, we agree that taking strategic solutions from the CSNP should support faster consenting and help CATOs to deliver network reinforcements in a timely manner, maximising the potential benefits to consumers.

We are engaging with the ESO and Ofgem regarding the development of the CSNP methodology and are committed to working with Ofgem to ensure that the development of the CSNP methodology and Early Competition approach are aligned.

It is important to note that the level of strategic optioneering and environmental assessment reflected in the tCSNP is not as mature as is anticipated will be required for the CSNP. This should be reflected in the choice of any tCSNP projects for competitive delivery to ensure that delays are avoided during planning and consenting that could increase costs for consumers. We would welcome further discussions with Ofgem to identify suitable pilot project(s) for competition now that the tCSNP is published and are pleased to see the ESO's and Ofgem's acknowledgement that tCSNP projects may require additional examination, including consideration of additional project specific factors not captured in the Cost Benefit Analysis.

We recognise the added benefits of aligning the CSNP and Early Competition in removing the need for TOs to assess bids (thereby reducing conflicts of interest), streamlining the tender process, and aligning with the likely delivery timescales required for network versus non-network solutions.

We also note the recommendation in the ECI to potentially have connection driven projects included in a competitive tender. We would welcome further discussion on how connection driven projects could be considered in future in the context of early competition.

Q3. Do you agree with the ESO's proposal that only network solutions should be eligible for Early Competition?

As above, from a tender process perspective, we agree that separating network and non-network solutions is beneficial given the typical required delivery timescales. However, this does limit the scope for innovation in design where, for example, battery storage and a network solution could be deployed together. Where the framework mandates that the two different types of solutions are tendered separately, this could lead to increased costs for consumers. We would welcome further consideration of how combinations of solutions can be considered in the future helping to facilitate a level playing field across TOs and third parties in terms of non-network solutions.

Q4. Do you have any material concerns with the conflict mitigation measures proposed by Ofgem for incumbent TOs and other bidders?

We want competition to drive the best outcomes for consumers, in line with the success factor we identify above. Having experienced and skilled people working on projects and allowing bidders to play to their strengths will help to achieve this. For competition to deliver the greatest benefit to consumers, conflict mitigation measures should not be overly

restrictive and prescriptive, thereby driving unnecessary embedded costs and eroding some of the intended benefits of competition.

As such we do not agree with the proposals, which we believe go further than is necessary to achieve the conflict mitigation objective outlined and if implemented could prevent TOs from participating effectively in a tender, thereby reducing competitive tension and overall benefits for consumers.

As the TO for England and Wales, we stand ready to support the tender process through provision of network information to prospective bidders and look forward to finalising the details of how this can operate most efficiently and effectively for all parties, as well as how TOs will recover the costs incurred in facilitating competition. Ofgem will need to ensure that appropriate disclosure arrangements are in place for any information which may need to be shared.

As outlined in the consultation document, the amended Early Competition approach eliminates the TO role in assessing potential bids, which was one of the central points of perceived conflict. We believe that the suggested approach to introduce licence conditions on TO conduct is a sensible way to ensure a transparent, timely and fair process.

In terms of the appropriate level of scrutiny applied to conflict mitigation measures, we believe that internal scrutiny is sufficient to ensure compliance and we have a 3-line of defence model that can be called on to do this. Indeed, such requirements outlined in the consultation could make it less attractive to TOs to participate in tenders, reducing competitive tension and overall benefits to consumers from the regime.

Our risk management and assurance activities take place through all levels of the organisation, whereby all business areas identify risks, and we test the effectiveness of our internal controls against a range of factors and how likely various risks (which may include conflicts of interest and business separation) are to materialise. Our first line of defence in managing these risks are the business units and functions that are responsible for taking, owning and managing risks through implementation of effective policies, processes and controls. The second line of defence is our NG Group assurance and risk teams who act as a Shared Service to all Group businesses and the Risk, Controls & Compliance teams that offer business advice, monitoring and assurance support to the first line business units. Furthermore, our Corporate Audit function resides in the third line and provides independent assurance over our risk management and internal control systems to Senior Directors, company Boards and to the NG plc Board itself.

Therefore, we consider that adding another external layer of audit will add complexity and cost to tender events. We expect Ofgem to have sufficient trust in the TO to act transparently and fairly and in line with any agreed conflict mitigation measures within the TO licence.

We would welcome further engagement with Ofgem to establish proportionate conflict of interest requirements that are mirrored for third parties, as required, to ensure a level playing field.

Q5. What are your views on our proposed modification to put in place timing requirements for when the TO must confirm its intention to bid and put in place conflict arrangements?

We do not agree with this proposal. The approach to minimising conflicts of interest should not restrict people who have the right skills and experience from delivering the best outcomes for consumers. While we have experience of managing the movement of employees between NG group businesses, as well as maintaining compliance with business separation and conflict of interest obligations, we do not agree that the proposed conflict mitigation arrangements for staff transfers are proportionate. Isolating a team for over 24 months when they will only be actively developing a bid for around 12 months of this period will drive unnecessary embedded costs. We allow staff to move between NG group businesses and functions where they have removed themselves from any commercially sensitive information before moving on. Rather than restricting employees' movements we could manage potential conflicts of interest of transfers via a checklist for Onshore Competition, for example. The costs of limiting staff transfers will be reflected in bids and may disproportionately affect the incumbent TOs, thereby reducing the potential pool of bidders. This would run counter to the success factor we outline above which that is focussed on maximising the benefits of the CATO regime for consumers.

There is also uncertainty on how Ofgem expects these measures would be implemented across the supply chain, for example, consultancy services.

Q6. What are your views on our proposed modification to restrict the transfer of TO employees between the Bidding Unit and the team undertaking the Tender Support Activities and pre-construction activity?

We agree that there should be separation between the team supporting the tender process and any staff involved in bidding into the same competitive tender to ensure that potential conflicts of interest are managed. However, the transfer of employees should not be unnecessarily restricted; as above, we have significant experience of managing the movement of employees between NG group businesses and maintaining compliance with business separation and

conflict of interest obligations. As such we do not believe a discrete management structure is required and would only serve to increase costs.

Further clarity on how the tender support activity will be funded would be welcomed because this could require resources as and when early competition becomes embedded, and more projects are tendered through the process.

Considering the breadth of expertise required in supporting the pre-construction activities, and supporting delivery of the success factor we outline above, it would be beneficial to the process to include employees with the right skills and knowledge in the bidding team. NG's experience from the Pathfinder process, demonstrates that having the right expertise to bid into competitions, and then deliver the projects, supports better outcomes for consumers.

Q7. What are your views on the proposed information sharing framework and, on the roles, assigned therein?

We agree with the proposed information sharing approach and for the ESO to anonymise information between the various parties during the tender process. This will help to ensure that there is no risk of certain parties being given an unfair advantage, or information being held back. Using the ESO as an intermediary will also enable better control around information flow and consistency. We have experience in managing commercially sensitive information on many activities, with corporate controls of our Business Management Standard (BMS) for Data, Data classifications and data ringfences and other compliance controls.

We support the proposal for an Information Sharing Framework and would welcome further clarity on the content as well as whether there will be opportunity to provide feedback on its development (including how information relating to critical national infrastructure is considered).

Ofgem will need to ensure that appropriate disclosure arrangements are in place for any information which may need to be shared. We would welcome clarity on how NDAs would interact with the proposed Information Sharing Framework and the opportunity to feed back on any draft NDA templates before they are included in the tender pack.

To ensure that all parties' expectations are aligned, we would suggest a Service Level Agreement would be beneficial to clarify how information will be provided by TOs on a timely and efficient basis to support the tender process.

With regards to the enduring information sharing arrangements (once the tender process has completed), we would expect that information sharing between CATO and TO parties (and others) will continue to be subject to the same statutory and regulatory restrictions on information exchange that apply today. We would welcome clarity from Ofgem on this point.

Q8. Do you have any material concerns with the company structure proposed for raising debt for Early Competition?

We agree with the principles for company structure that Ofgem is seeking to achieve including demonstration of accurate debt pricing, the ability to ringfence and transfer assets, and the absence of cross subsidies.

We believe that these principles can be achieved through either an SPV or corporate structure. We have controls in place to prevent cross subsidies and there is a licence condition preventing cross subsidies. Introducing duplicative requirements which TOs already have an obligation in the licence to comply with will not support the success factor we outline above; it will reduce parties' appetites to bid, thereby reducing competitive tension and the potential benefits that can be delivered to consumers.

External verification of debt pricing, such as bank advice or consultancy services could be employed where necessary to evidence the requirements under a corporate structure approach. As such, we do not believe the SPV approach should be mandated and that bidders should be able to choose the route most appropriate for them so as to ensure that the bidding pool is as wide as possible.

Q9. Do you have any material concerns with the ESO's proposed methodology of its CBA model and the elements considered therein?

We welcome the commitment to continue to refine the CBA methodology, learning from the pilot process, and refining the benchmarks and data used as more projects progress through the competitive process and in particular the amendment to allow for both benefit and disbenefit to be considered in the qualitative assessment.

However, we still have concerns that, as it stands, the CBA will not effectively identify projects that will deliver benefits to consumers through competition. Much of our feedback to the consultation is not reflected in the updated methodology and we have further concerns with some of the assumptions and approaches. For example, both the factual and counterfactual cases should use a new debt cost because new debt will need to be raised to fund any new project whether that is by the TO or CATO (therefore, using the RIIO cost of debt allowance that includes embedded debt is flawed). The assumed equity return benchmark is based on macroeconomic conditions which change over time and so should be used cautiously. It is our understanding that the treatment of tax in the methodology may be incorrect. The CBA model logic diagram depicts a Pre-tax WACC which is not applicable to the RIIO framework and therefore overstates the costs of the counterfactual. A vanilla WACC is used in RIIO (which includes a post-tax cost of equity).

It is important that the CBA considers the overall security and resilience of the GB system. For example, introducing further parties who may own and operate infrastructure on the network may have implications on how the Electricity System Restoration Standard (ESRS) will be achieved. This may lead to a greater risk of mis-coordination in a restoration event and so interfaces will need to be appropriately considered and managed. Furthermore, we consider a CATO would also need to adhere to the TO requirements as set out in the ESRS. We welcome further clarity on the potential impact(s) to obligations outlined in ESRS as a result of competition (such as an increased number of network parties and interfaces).

We would welcome the opportunity to work through our concerns and recommendations in detail and to make refinements to the CBA methodology for use in identifying the pilot project, where these can be accommodated.

Despite our concerns with aspects of the methodology, we believe that the best way to move forward is to test the process with a commitment to conduct a lessons learned exercise after the first tender to identify where additional information and revised benchmarks can help with future assessments. This would include a commitment from Ofgem and the ESO to update the CBA methodology following this exercise. For competition to be successful the market will need to have confidence in the process - as such, we believe that even where a competitive process reveals a higher market price than the counterfactual this should be honoured.

We appreciate the acknowledgement that tCSNP projects will require additional examination, on top of the CBA, to identify suitable project(s) for competition. We would be happy to feed into these considerations based on our own assessments to ensure that competition can facilitate the successful delivery of the project, demonstrating the concept of onshore competition and delivering benefit for consumers.

Q10. Do you have any material concerns with the proposed TNUoS revenue recovery model for a CATO similar to the OFTO model?

We understand the driver for this proposal which is intended to benefit consumers through attracting a wider pool of bidders and to promote effective competition. However, it will increase the risk borne by the TOs in terms of TNUoS under-recovery. We welcome Ofgem's commitment to revisit this decision in future, depending on the level of CATO penetration in onshore transmission network ownership. In particular, lessons from the pilots could be used to inform future policy (including in relation to risk exposure for TOs related to increasing external revenue streams being recovered through TNUoS).

We look forward to future consultation on the commercial model in due course to ensure that allowed revenues are reflective of the wider landscape that bidders will be operating in; for example, considering the challenges in securing supply chain capacity.

Q11. Do you have any material concerns about the proposed approach and principles in dealing with a situation of CATO/tender failure?

We are pleased to see that the CATO OLR process is expected only to be used after all other avenues have been exhausted. It is important to recognise that taking on projects unexpectedly will have impacts across our portfolio and other obligations would need to be revisited to ensure that the whole package is deliverable and realistic. We would expect that similar principles to those contained in Standard Licence Condition B18 for OFTO OLR would apply to the CATO OLR approach.

It will be important for any process to appoint a CATO OLR to reflect where the CATO project is in terms of development, i.e. operational versus construction versus pre-construction, and the risk profile of the project. For example, failure of a CATO before construction could indicate a project that is more difficult to deliver (with the implication that additional allowances would be required to enable successful delivery). Consideration will also need to be given to both the impact on the appointed CATO OLR and its existing activities, as well as the likely potential costs to consumers of any delay in asset delivery.

Alongside considering the impacts on delivery across the whole portfolio, it is unclear on what terms a TO would be expected to take on such projects. We would welcome confirmation from Ofgem that the terms on which a project would be transferred would be agreed by Ofgem and the CATO OLR ahead of transfer, and that these will be adapted as necessary to reflect the risk profile of the project and the delivery ambition. It is possible that significant delays in delivery could result from a project going through a CATO OLR process. For example, for projects that are yet to be constructed, network outages may be scheduled to accommodate delivery and if missed would lead to significant delays. This risk can be mitigated by allowing costs of ambitious delivery to be passed through as required.

The route for obtaining allowances to deliver such projects is also unclear. We would welcome further clarity from Ofgem on how this would be achieved under the RIIO framework. The overall level of project risk exposure to the CATO OLR and associated implications for returns would also need to be considered.

Where a competitive element is sought to be retained in appointing a CATO OLR, we support the OFTO OLR approach where Ofgem invites proposals from relevant licensees. This will help to drive good outcomes for consumers by encouraging a wider pool of bidders.

We would welcome further clarity from Ofgem whether it will be mandatory in any scenarios of CATO failure for the TO to take on a project.

Where an asset is operational at the point a CATO OLR process is initiated, due consideration will need to be given to the health of the assets to allow for sufficient due diligence to be conducted, and for this to be reflected in bids submitted. Furthermore, we expect that a CATO would need to comply with the relevant industry codes and standards in developing and operating assets (such as the SQSS and Grid Code).