

FAO: Thomas Johns, Head of Onshore Competition

By email: [Thomas.Johns@ofgem.gov.uk](mailto:Thomas.Johns@ofgem.gov.uk)

28 March 2024

Dear Thomas,

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

Transmission Investment (TI) is a leading independent electricity transmission business in the UK, with over ten years of experience developing, acquiring and managing large complex infrastructure projects. TI manages one of the largest offshore electricity transmission portfolios in Great Britain (GB), in total we currently manage approximately 4GW of transmission and £3billion in capital employed. TI is also leading the development of two electricity interconnector projects in support of the UK's Net Zero ambition. This includes a proposed 700MW link between Northern Ireland and Scotland known as "LirIC", as well as the FAB interconnector between GB and France. We are a strong advocate of introducing competition to deliver electricity transmission faster and cheaper, and we continue to support the development of the required arrangements for these competitive processes.

We welcome Ofgem's consultation on policy updates to Early Competition in onshore electricity transmission networks. Overall, we are generally supportive of Ofgem's latest thinking and policy proposals outlined in the consultation. The current narrative for accelerating the delivery of transmission suggests that incumbent delivery, whilst more expensive, increases certainty of timely delivery, whilst competition is less certain but lower cost. The extensive research by CEPA debunks this narrative, and highlights that there are risks inherent in taking one or other path, alongside common issues such as supply chain constraints. Therefore, utilising both competitive and incumbent approaches is the most sensible way forward to ensure greater delivery resilience for such a large capital programme of transmission infrastructure. Competition encourages innovation and the delivery of benefits to consumers more quickly and cheaply, with strong incentives to deliver on time and on budget. We also welcome ESO's "Beyond 2030" Report, which lists the projects which meet the early and late eligibility criteria for competition, subject to the cost benefit analysis. Whilst we are pleased to see the progress in Early Competition, the continuing lack of a framework for Late Competition will continue to mean that consumers are missing out on the benefits.

TI commissioned CEPA to revisit the benefits of competition in onshore electricity transmission in the current context. The full report is attached as an annex to our response, and we summarise the key points below.

### **The importance of a stable pipeline of projects**

Competition benefits are best realised when there is a large and stable pipeline of projects to be competed, where learnings and efficiencies can be rapidly built on by all involved.<sup>1</sup> This is evidenced by the success of the OFTO regime and the CfD auction rounds, supporting investor confidence, interest, and over the years reducing the transaction costs associated with the process. The revised *Criteria Regulations*<sup>2</sup> (recently laid in Parliament) state that competition processes should be used for all

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<sup>1</sup> CEPA report, page 4, page 14-19

<sup>2</sup> The Electricity (Criteria for Relevant Electricity Projects) (Transmission) Regulations 2024, 7.—(1) *A cost-benefit analysis in respect of a project must demonstrate that the non-tendered consumer impact does not outweigh the tendered consumer impact.*

projects unless there is no realistic scenario where consumers can benefit<sup>3</sup>. This default to competition approach, once applied consistently across all policy thinking, will better ensure the pipeline is strong and will build confidence for investors and the supply chain that CATOs are an additional and reliable alternative route for the delivery of transmission network infrastructure.

A clear pipeline of projects, with a regular cadence of competitive tenders will incentivise third-parties to invest in their capability and associated supply chain.<sup>4</sup> This will increase the available management capacity and provide greater resilience to the supply chains, which we need to deliver the investment required to meet Net Zero and will better avoid future skills and capacity constraints experienced today. To date onshore grid investment has been delivered through RIIO arrangements which has seen limited parties winning large, long-term RIIO-linked frameworks meaning the potential for supply chain diversification may have been lost.

Enabling the pipeline of projects is reliant on the National Energy System Operator (NESO) having the appropriate skills and resource to do so. The costs of NESO building sufficient capacity is small compared to the benefits of competition and therefore it appears sensible to avoid any constraint that may prevent the pipeline of projects being competed. Therefore, a clear signal is needed to the NESO to quickly scale its capability to support the pipeline and provide the confidence to bidders to invest in the opportunity to deliver benefits to GB consumers.

### **Avoiding unconscious bias towards RIIO arrangements**

We observe there appears to still be an implicit assumption that delivery of transmission infrastructure through traditional RIIO arrangements provides greater certainty of delivery. It is important this assumption is properly tested and does not unduly influence decisions on which projects should progress through competition. The research by CEPA starts to test these assumptions, demonstrating that in fact there is little evidence to support these claims.

#### *Incentives on transmission owners*

A competitive delivery model incentivises a greater focus on delivery. A competitively appointed transmission owner is likely to be almost entirely focussed on delivering the new transmission asset on time and to cost. This is supported by the fact that they will not be paid any revenue until the asset is operational. By comparison incumbent transmission owners will have multiple objectives they need to balance, and it would appear to date that their incentives to deliver on time have not been as strong (evidenced below). In addition, the tender itself can be designed in such a way to encourage and facilitate timely delivery. This has been evidenced in the US where there are several examples of competitively procured projects being delivered ahead of schedule, or below budget<sup>5</sup>.

#### *Timelines*

We note there appears to be an assumption that running a tender process may increase timelines, because it is an extra step not required under a regulated model. CEPA provides evidence that competition may be very similar to the incumbent delivery timeline.<sup>6</sup> As illustrated in the diagram below, the tender process, if designed effectively, may take a period of approximately 16 months to run. In parallel, it is reasonable to expect that the solution design would also be able to take place. Given that the winning bidder is then heavily incentivised to deliver, namely because they do not receive revenue until the project is commissioned, it is reasonable to expect a time saving. Incumbent TOs do not face this same incentive, being more certain of revenues via the price control, and in the

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<sup>3</sup> This is a change in comparison to the draft Criteria Regulations, which required the CBA for the tendered solution to be “better” before running a competition. The emphasis of the final Criteria Regulation is for tendering to take place unless it is shown that incumbent delivery CBA is “better”.

<sup>4</sup> CEPA report, page 18

<sup>5</sup> CEPA report, page 31

<sup>6</sup> CEPA report, page 31 and 32

case of ASTI delivery, are able to deliver up to 12 months late with no penalty. CEPA's research also highlights that of sixteen Transmission Owner Major Projects (monitored by the Energy Networks Strategy Group<sup>7</sup>) just under half were delayed by more than six months, and a quarter delayed by more than twelve months, with a further three being delayed by over 2 years. Therefore, when you combine the potential time savings, as well as the risk of incumbent delay, it is clear that running a competitive tender will have little to no material impact on delivery timescales and constraint costs.

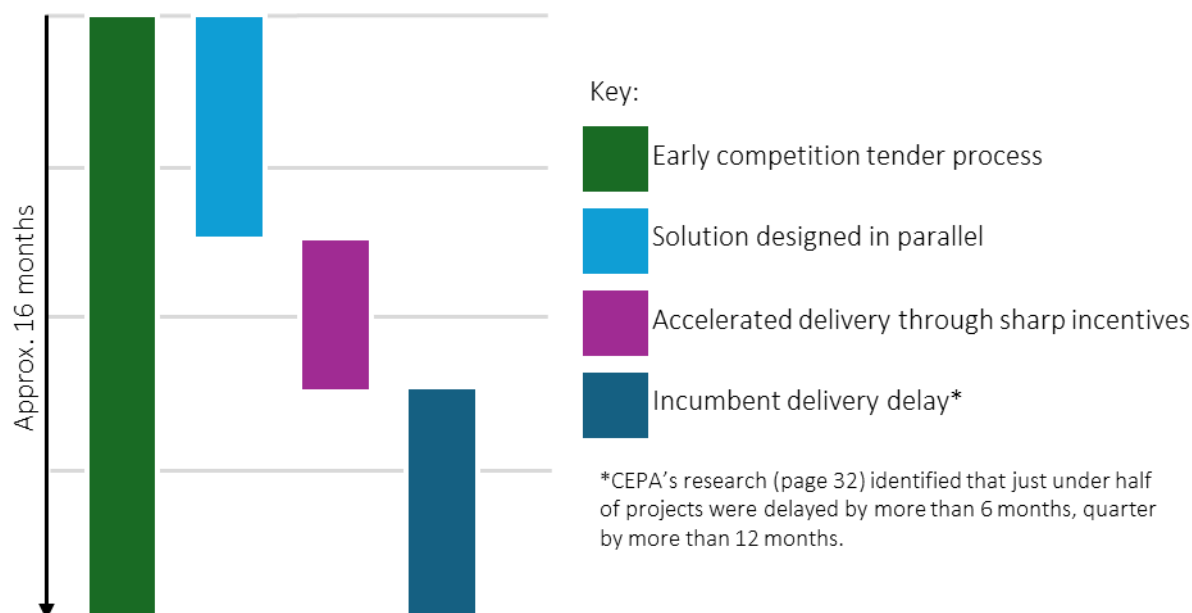


Figure 1- Impact of tender process on timelines

### Contagion effect

A delivery model with a high reliance upon RIIO programme delivery can amplify the risks already associated with the delivery of a large capital programme and creates single points of failure<sup>8</sup>. Managing the delivery of a programme of multiple large-scale projects, on time, on budget, alongside maintaining the operation and performance of the existing network, whilst remaining within financial constraints, is a huge undertaking and challenges management capacity as projects inevitably hit complications.

A delivery model reliant on a single managing entity (rather than breaking it up into competed projects with dedicated management teams) could risk the delivery of the entire capital programme. Where a risk materialises in one project, it typically causes a ripple effect through the whole organisation leading to a contagion effect for the entire programme within that entity. An example of this is Network Rail's programme of large-scale electrification projects across the GB rail network during its fifth control period during 2014 and 2019. The costs of one project in the programme increased materially (from £0.8bn to £2.8bn) and it was eventually cancelled. The failure of this project led to a pause in the delivery of the whole programme, and eventually most of the programme being indefinitely delayed or cancelled. It also materialised that Network Rail had overspent its capital allowance by £10bn<sup>9</sup>.

### Project Size

The CEPA report concluded there are benefits of competition for projects of any scale. The ability to deliver benefits relies on a level playing field, including around the management of interfaces and integration of new projects with the existing system. The technical interfaces and engineering risks are

<sup>7</sup> Industrial Strategy (2022) Electricity transmission networks: major projects update. Available at: [Electricity transmission networks: major projects update - GOV.UK \(www.gov.uk\)](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/101444/electricity-transmission-networks-major-projects-update-2022.pdf)

<sup>8</sup> CEPA report, page 24

<sup>9</sup> CEPA report, Case Study: The electrification of the Great Western Mainline and the disruption to Network Rail's Capital Programme, page 25

in essence the same whether a project is delivered by a third party or the incumbent. If it were to be assumed that larger, more complex projects are better delivered through an incumbent organisation, this would appear to suggest that the management of these engineering interfaces would be different, e.g. perhaps a more formalised and structured compliance approach, when bringing a new large and complex project onto the existing system. If the management is done differently when internalised, e.g. less formally, this would suggest the consumer is exposed to some additional risk, compared to a competitive model, where it might be expected for them to transparently and explicitly demonstrate the mitigation of risks. Such a process effectively transfers this risk away from the consumer to the third-party developer. If this is the assumption, this implicit risk allocation benefit should be recognised in the trade-off between the two models, a more pragmatic assumption might be that there should be no discernible difference in the compliance and management approach between a competitive or incumbent delivery of a large, complex project.

### **The Cost Benefit Analysis Framework**

We are generally supportive of the proposals for the CBA Framework and would like to impress the importance that the results interpretation should be aligned to the policy stated in the revised Criteria Regulation. The regulation expects competition to be taken forward where it is likely to be equal or better than incumbent delivery.

There are some assumptions regarding how costs relate to the factual and counterfactual cases in the CBA which may not be sound and therefore understating the potential consumer benefits.

#### *First of a Kind premium*

Including a Foak premium risks double-counting. It is unknown what the frontier efficient costs are for the pre-Tender, Tender or Bidder costs, and therefore to apply a premium to the current estimated efficient Tender and Bidder costs may overly burden early tenders. This would likely put barriers in the way to utilising competition, which in of itself prevents the learning that would drive these costs down. This is a cost of change and therefore should be considered across the overall programme (as later projects will be more efficiently competed based on the learnings from the earlier ones), recognising that it is a necessary cost for consumers to access the order-of-magnitudes greater long-term benefits from competition.

The calculation of the premium appears to require some estimate of the learning rate and attribution to early projects. This in itself appears to be an unnecessary complexity in the modelling, given the scale of overall benefits that the wider policy is seeking to deliver and the implied transitory nature of the effect.

#### *Constraint costs*

The analysis presented through the CEPA report suggests that the likely experienced difference in timelines, between counterfactual (noting early indications of projects under ASTI are already seeing typical delays), and the ESOs shortened tender process would lead to minimal differences in delivery timeframes. It will be important to seek to ensure there are realistic programme estimates for both the factual (as no bidder programmes will be known) and counterfactual (where past evidence suggests a degree of optimism bias), especially where this may be the deciding factor as to whether a project would be best delivered through competition.

#### *Pipeline and programme effects*

It is important to ensure the CBA considers the wider benefits of competed projects. This includes a number of the benefits articulated earlier in our response such as supply chain investment, increased financial capacity and resilience to avoid slowing the pipeline of projects coming to market. The CBA

should also reflect the innovation and learning from each competition process, which is applied to the rest of the programme.

### **Conflicts of interest mitigation**

We welcome the proposals (Chapter four) to mitigate conflicts of interest during the tender process in order to ensure a level-playing field between commercial and regulated bidders. In particular, we are supportive of Ofgem's preferred approach to require a Special Purpose Vehicle (SPV) for each project. We agree with Ofgem's view that this would allow for the appropriate separation and ring-fencing of the project-specific assets from the wider TO asset base and ensure that the competitive tender is taking place fairly. In addition, if a party fails to deliver a project it is likely to be so damaging to its reputation in future tenders, that there are extremely strong incentives on delivery, which go beyond those in a RIIO-type regulatory model<sup>10</sup>. It is not clear, except for the specific case of the incumbents that there would be many organisations that would not seek to establish an SPV for these projects. It is prevalent across other related industries, e.g. offshore renewable projects, that while they have large utility owners, the projects themselves are SPVs. They benefit from their affiliation with their parent but are separable and distinct from the rest of the business. There appears to be little evidence that adopting a SPV approach would dissuade a material number of bidders or be a barrier to TOs participating where they are able to establish suitable structures for separation of their businesses as required by all other licensee parties in the sector.

We hope the contents of the letter are helpful and we would be pleased discuss any points raised.

Yours faithfully,



**Mark Fitch**  
Corporate Development Director

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<sup>10</sup> CEPA Report, page 26