

By email: RIIO3@ofgem.gov.uk

18 December 2024

Dear Margaret,

Consultation on the Electricity Transmission Advanced Procurement Mechanism

This response is prepared on behalf of SSEN Transmission, part of the SSE Group, responsible for the electricity transmission network in the north of Scotland. We welcome the constructive and collaborative engagement with Ofgem to date on the development of the Advanced Procurement Mechanism and the opportunity to respond to Ofgem's consultation on the design and implementation of the final mechanism.

We provide an overview of our key reflections and feedback on the proposals made in the consultation below. Our answers to the consultation questions are provided in appendix 1 attached to this response, and we have provided some additional complementary information in our confidential appendix 2.

As outlined in our recently submitted RIIO-T3 Business Plan, our mission is to deliver a network for net zero. Supply Chain Resilience is a critical enabler in achieving this. To meet 2030 targets, on the road to net zero, we have developed an ambitious approach that will foster a resilient and sustainable supply chain capable of delivering the unprecedented investment required for our network. Our Supply Chain Resilience Strategy, submitted within our Plan, sets out how we are securing long-term capacity and maintaining maximum competitive tension within this challenging procurement environment.

We recognise that the RIIO-T3 period will be shaped by unprecedented growth in the transmission and energy sectors. Large-scale investments, both in the UK and internationally, have created a market where demand significantly exceeds supply when it comes to procurement of equipment and services.

The context in which our supply chains are being built and managed has changed significantly since the start of RIIO-T1, and particularly since 2021 in response to various and concurrent global events. Markets started to experience inflationary pressures after the easing of COVID-19 restrictions and the impacts of geopolitical unrest. These events, coupled with significant growth in the international energy sector, caused a shift in market conditions. Whilst our demand for works and goods is expected to continue to grow at unprecedented rates within the RIIO-T3 period, so too will growth in international transmission requirements. The total volume of UK transmission procurement will therefore remain low relative to international competitors that are attempting to secure the same assets and resources.

Supply chain feedback and intelligence indicates that suppliers across all asset categories are experiencing supply issues and are expecting these to worsen over the coming years. The increase in demand is already reflected in rising lead times and even once equipment has been secured following long lead times, project deliverability and mobilisation are being threatened by a shortage of onshore transmission workers.

In order to be effective, it is therefore crucial that the APM is designed in a way that is cognisant and complements each TO's supply chain and delivery strategies.

Engagement with our supply chain has highlighted the need to significantly increase and invest in the industry's workforce to deliver this investment programme, with the industry facing challenges in securing appropriate resource to deliver projects. There remain considerable skills constraints, particularly in specialist trades, for example, overhead line (OHL) and commissioning engineers, and in front-end design. We recently shared a Deloitte study commissioned during May - June 2024 which provides some more independent analysis on such supply chain constraints. Supply chain decisions to invest in increased capacity (manufacturing or workforce) requires confidence that capital costs will be recoverable. Therefore, as well as highlighting the need for accelerated procurement to secure scarce supplies, there is the **need for longer term investment certainty to trigger increased capacity and for investment in manufacturing capacity and skills** to facilitate the delivery of large numbers of concurrent projects.

As Ofgem is aware we have made significant progress in our early procurement commitments for our ASTI projects. We have secured the cable and convertor supply chain that is critical to our offshore ASTI projects, and for our onshore ASTI projects successfully procured key overhead line components (such as steel tower fabrication) and transformers. Alongside the early approval of need, access to allowances via Early Construction Funding (ECF) to secure the supply chain has been a critical enabler to achieving these milestones and derisking the delivery of our ASTI portfolio.

In light of the increasingly challenging supply chain environment, it is crucial that we can build on the lessons and our successes with our procurement approach for ASTI for subsequent investments required for the T3 period and beyond. **Early clarity on investment pipelines** and **access to early funding** were the key enablers to this success.

We believe that with marginally more flexibility under the APM than currently proposed, the TOs will be much better placed to secure the supply chain required to deliver the pipeline of investments required across our network. We believe this can be done through the introduction of the following changes.

➤ **The APM should enable TOs to procure programmes of work.**

We understand that the supply chain are already prioritising customers who procure programmes of work rather than individual projects. The TOs need to be enabled to procure in ways that attract competitive bids and support suppliers to invest in extra capacity and workforce.

Accelerated approval of programmes of work (e.g. tCNSP2, T3 baseline, CPP30) along with flexible advanced procurement funding for a broader range of supply chain activities brings the most benefit. This was demonstrated through the introduction of ASTI and Early Construction Funding, and we continue to believe this applies. The ability to secure the supply chain to mobilise and deliver projects is equally, if not more, critical than securing long lead equipment. This position is supported by our various supply chain partners.

We understand that Ofgem intends for the APM to be used ahead of specific project approval and does not want approval of allowances to be considered as implicit approval of any specific project. However, the current proposals will reduce our use of the APM to a limited scope of supply chain activities before the point at which we have further certainty on pipelines of approved projects.

➤ **The APM must be designed to complement each TOs contracting and delivery strategies, not require us to change them.**

Much of the proposals in Ofgem's consultation, particularly around demonstrating fungible and flexible procurement, are more relevant to where TOs directly purchase individual pieces of equipment from Original Equipment Manufacturers (OEMs) rather than procuring for the delivery of projects. Whilst particular types of equipment could typically be classed as more fungible or flexible from a technical/engineering perspective, the actual fungibility or flexibility of any assets that have been procured will depend on the contractual arrangement with the supply chain partner and whether this allows for the transfer of specific assets between projects. Our delivery strategies have been established to enable the safe and efficient delivery of our programmes of work and to help build and maintain a resilient supply chain for future work. It is important that the TOs are not limited from utilising the APM due to their individual delivery strategies or that Ofgem imposes a change to delivery strategies. We are concerned that some of Ofgem's eligibility proposals to allow TOS to use the APM will have this effect.

- **Remove the 20% cap and allow the APM to release allowances in line with the financial commitments that TOs are required to make to secure the supply chain.**

The placing of 20% deposits is not reflective of the actual financial commitments TOs are required to make to secure equipment or the supply chain, with actual commitments varying between supplier, asset type and contractual conditions relevant to any specific project. This is demonstrated by the advance payment requirements of our current procurement programmes. If Ofgem retains an arbitrary cap which does not reflect the financial commitments the TOs are required to make across all equipment and services, then this will unnecessarily restrict use of the mechanism. In such circumstances the APM will only work where the supply chain has low advanced payment requirements, e.g. anything falling under the proposed cap, or where there already exists regulatory approval of need and the under recovery of the financial commitment will only endure for a short period until the cost assessment is concluded. Ofgem will assess the TOs planned supply chain activities, including forecast payments/cancellation curves etc, when determining our first (and then subsequent) UIOLI allowance requests. Once the final UIOLI allowance has been determined, TOs should then have the flexibility to use their allowance for the range of activities outlined in their request, with all expenditure to be reported for reconciliation purposes as per Ofgem's current proposals. Final allowances will still be subject to an efficiency assessment at the reconciliation stage when full costs associated with delivery of specific investments are submitted for approval.

Overall, we are supportive with Ofgem's proposal to introduce the Advanced Procurement Mechanism and the intent to design a regulatory framework that allows TOs to engage the supply chain in a manner that attracts as much interest as possible. However, enabling TOs to secure the supply chain at an early stage and procure at a scale needs to be coupled with longer-term visibility and confidence of the pipeline of work that both TOs and the supply chain are being asked to deliver. This combined approach will gain traction with the supply chain, and we look forward to continuing to work with Ofgem to ensure the APM is developed to help facilitate this.

Yours sincerely,

Lois Paton

Head of Regulation, SSEN Transmission

Appendix 1: Consultation Questions

1. Do you agree with our proposal to introduce the Advanced Procurement Mechanism to address supply chain constraints faced by the transmission owners?

We agree with Ofgem's proposal to introduce the Advanced Procurement Mechanism and the intent to design a regulatory framework that allows TOs to engage the supply chain in a manner that attracts as much interest as possible. Enabling TOs to secure the supply chain at an early stage and procure at a scale needs to be coupled with longer-term visibility and confidence of the pipeline of work both TOs and the supply chain are being asked to deliver. It is this combined approach will gain traction with the supply chain.

We would caution against Ofgem's assertion that the APM would bring forward billions of pounds in allowances to derisk the transmission owners in booking capacity for equipment **years in advance of when it is needed**. The APM, if properly designed, will enable the TOs to secure the equipment, services and workforce **in time** for us to deliver the investments needed our network by 2030 (and beyond). With no current proposals from Ofgem to introduce an equivalent to the ECF mechanism under the funding framework for tCSNP2 or within the wider RIIO-T3 regulatory framework (including uncertainty mechanisms) the APM will be a critical enabler to derisking the delivery of the unprecedented investment required on our network within and beyond the RIIO-T3 period.

We are unsure that the APM will enable TOs to secure the supply chain 'in bulk' when compared with ECF under ASTI. Regulatory approval of a programme of work, coupled with access to ECF enabled us to undertake a strategic and targeted approach to securing the supply chain, which included 'bundling' some of our asset across various projects in order to make our procurement activities more attractive to potential bidders due to volume and scale.

Q2. Do you agree with our proposed framework for evaluating eligibility?

We believe Ofgem's proposed framework for evaluating eligibility has the potential to be overly onerous and risks deterring TOs from fully utilising the APM. It is not clear from the proposals at which stage the TOs would be required to demonstrate the various eligibility criteria but based on our interpretation of the proposals we provide the following initial reflections.

We don't think it should be a requirement for the TOs to provide further evidence of constraint when making their UIOLI reopener submission. It is not clear from para 2.6 whether Ofgem is proposing this for all reopener requests even where it has already been decided through this consultation process that a particular asset type has been determined as eligible, or if the requirement to demonstrate constraint only applies where the TO is looking to add a new asset to the eligibility list.

It is also not clear when TOs will be required to provide Ofgem of a 'full breakdown as to what will be included in the relevant supplier contract', and specifically whether this would be at the point of utilising our UIOLI allowance. We support the proposal for tracking actual payments made, including unit rates through ongoing reporting through the APM tracker and would suggest the Ofgem works with TOs to develop the APM reporting template so that TOs can provide a suitable level of additional information as required when tracking spend of their UIOLI allowance. The efficiency of our contractual and resultant costs will be subject to assessment during the final cost assessment stage.

Ofgem's proposal under para 2.7 suggests that when making our UIOLI reopener submission the TOs will be required to provide analysis of the impact and benefits case of our full forecast pipeline of projects for which we want the APM to apply. We have recently submitted our RIIO-T3 Business Plan which outlines

the need and benefits case of the various investments we need to make on our network within the RIIO-T3 period (linked to specific delivery timescales). Similarly, the benefits case of the recommended EISDs for our tCNSP2 projects and need for further network investments to meet the Government's CPP30 ambition have all been clearly outlined. We do not think it should be necessary for TOs to re-state the case for current delivery dates and impact of delay, particularly against the current net zero and CPP30 backdrop. Our ability to deliver this programme of investments by 2030 and beyond will be reliant, but not limited to, our ability to secure the supply chain in the coming years. As noted by Ofgem in the consultation, the purpose of the APM is to simply bring forward spending that would otherwise happen later (once projects reach specific funding milestones), rather than approving additional spend. The APM should enable the TOs to confidently bring forward project spend to undertake relevant activities with the supply chain (whether that be for example, securing equipment or contractors) to derisk delivery.

Q3. Do you agree with how we have defined supply chain constraints?

We agree with Ofgem that it is important that the APM addresses supply chain constraints that risk delays to overall project delivery. When referring to constraints, however, it is important that Ofgem does not limit this to just capacity constraints leading to long lead times. Increasing demand, leading to constraints can also lead to a reluctance for supply chain to bid for works at all, so it is important that the TOs are enabled to remain attractive to prospective bidders.

As such, we disagree with Ofgem's proposal that the APM should only be used for asset types where lead times can be demonstrated as being above normal 'tolerable' levels. The TOs will be required to deliver huge programmes of work concurrently over a compressed timeframe in order to meet 2030 and beyond targets. With competing demand for scarce supply chain resources, even where lead times have not increased beyond what we have experienced in recent years, the ability to secure the supply chain at all will be challenging. Assets and contractor capacity will continue to become constrained due to aggregated UK and Global demand.

All of this combined means the TOs need to be able to do things differently in order to contract earlier and be the 'customer of choice' for the supply chain. Ofgem should have confidence that the TOs will only secure assets within the timescales required to enable delivery, which will be linked to clear delivery strategies for specific investments. The APM should naturally only be used where required to secure assets or wider supply chain before the point at which an alternative route to recovering allowances is available.

As per our response to Question 2, it is not clear from para 2.6 or para 2.10 whether Ofgem is proposing that for any UIOLI reopener request TOs will be required to re-demonstrate constraint and the benefit of advancing procurement, even where it has already been decided through this consultation process that a particular asset type has been determined as eligible. The outcome of this consultation should be an agreed policy and list of eligible activities covered by the APM. Ofgem's proposal that the TOs will be required to provide evidence of project specific impact of delay also seems to go against the intent of the APM being project agnostic.

Q4. What are your views on which equipment types are most constrained, which are at risk of future constraint, and which are less of a concern, and what are your views on the items we should include within the scope of the APM?

We refer to our response to Question 3 which outlines the need for Ofgem to consider constraint challenges more holistically and not limit the use of the APM to just equipment with specific long lead times. In the absence of any alternative route (e.g. project specific or programmatic ECF) to access allowances to secure supply chain the APM must enable TOs to secure any relevant equipment or service required to derisk delivery. By limiting the use of the APM to just a pre-defined list of equipment risks enabling the TOs to only secure part of what is needed to actually deliver, with the rest to come later, which reduces the value of the APM being in place.

Notwithstanding this, we have provided a confidential appendix¹ with our latest view of current lead times against the asset categories listed in the consultation.

A number of independent reports have been produced and made publicly available by industry over the past 18 months, with all studies presenting findings of a constrained global market across the supply chain. We are committed to continuing to work with Ofgem, Government and the wider industry to support this ongoing market assessment on an enduring basis. Current supply chain challenges will impact not only TOs but other parties such as developers, DNOs, and the wider supply chain itself (e.g. OEMs and contractors are facing equivalent challenges to the TOs in terms of securing the workforce, raw materials etc.). Therefore, we don't think further market assessments should be limited to providing just the TO view on the constraints being experienced. Ofgem and Government should consider the merits of a more holistic market assessment which the TOs can input into as a relevant stakeholder.

Q5. What are your views on our intention to exclude strategic procurement from the APM, and the potential benefits of later expanding the APM to include it?

It is not clear from the description in the consultation, what would be classed as strategic procurement. But on the basis that this is being described as procurement across all TO activities even where constraints are not evident, and under the definition of constraint Ofgem mean only long lead equipment, we would argue that the APM should be used for strategic procurement related to the delivery of projects. We would not be proposing that the APM should be used to 'strategically' bulk buy non-constrained equipment in anticipation of this being required in the future. However, similarly we also do not believe the APM should be designed to do this for constrained equipment.

Q6. Do you agree with how we have characterised fungible, flexible and bespoke procurement, and our proposed treatments of each of these? Do these definitions reflect real world contracting and engineering realities?

The definitions of fungible, flexible and bespoke provided in the consultation seem to be more relevant to the direct purchase of individual pieces of equipment from Original Equipment Manufacturers (OEMs). Whilst particular types of equipment could typically be classed as more fungible than others due to their standard nature (e.g. wood poles or steel towers), the actual fungibility or flexibility is more directly related to the contractual arrangement with the supply chain partner and whether this allows for the transfer of specific assets between projects. As previously shared with Ofgem, the bulk of our procurement activities are contracted through our Principal Contractors, who we contract with for the delivery of projects rather than just purchase of equipment.

¹ Confidential Appendix 2: SSEN-T additional information in response to APM consultation

We have provided a confidential annex with further detail on the applicability of the fungible, flexible and bespoke definitions against each of the asset categories based on our current delivery approach.

By allowing more freedom under the APM for procurement activities that are deemed fungible or flexible, Ofgem is at risk of favouring specific contracting and delivery approaches over others, rather than designing an equal playing field for all TOs to access allowances to secure their supply chain regardless of delivery strategy.

We think Ofgem should use the annual reopener window to scrutinise TOs submissions for planned supply chain activities linked to forecast programmes of work. If approved (resulting in a UIOLI allowance), then the TOs should have the confidence and flexibility to utilise the agreed allowances for the activities set out in their submissions without the requirement to request further reopeners for 'bespoke' procurement.

Q7. Do you agree with our proposed approach to funding services contracts through the APM?

We are supportive of Ofgem's proposal to include 'Indirect Procurement' within the scope of the APM and welcome the constructive engagement with Ofgem on this proposal to date given its criticality to our delivery approach. For clarity, this is not *indirect procurement of services* as described in Ofgem's consultation. Under a turnkey delivery approach we will contract directly with a Principal Contractor for the delivery of a project who will/may in turn sub-contract out particular elements of delivery (services) as well as either directly procure equipment on our behalf or via their own contractors. We may still directly purchase specific equipment and free-issue this to our Principal Contractors.

The definitions of fungible and flexible are not applicable to this type of contracting approach due to the fact we are contracting for delivery of a project. Consideration must also be given to our obligations as a regulated entity under the Utilities Contract Regulations, with all contract allocations required to go through a process of competitive tendering. The ability to then change or move the terms of a competitively tendered contract to another project without going through another competitive tender event could result in us being in breach of these Regulations. As outlined in response to Question 6, reference to fungible or flexible procurement as defined in the consultation seems to be more relevant to the direct purchase of equipment from OEMs with this equipment later free-issued to contractors for installation associated with a project.

Q8. Do you agree with our rationale for using a UIOLI mechanism for the majority of APM expenditure, rather than other regulatory tools?

Overall, we agree with Ofgem's rationale for using Use it or Lose it (UIOLI) funding as the basis for the APM. It provides greater flexibility and removes the need for specific PCDs attached to ex ante funding. This approach should also give Ofgem the confidence to enable sufficient allowances to facilitate advance procurement. We fully agree that any underspend of these allowances should be returned in full to consumers and the use of Price Control Deliverables (PCDs) would add a disproportionate level of regulatory burden and risk project delays, the opposite of what this mechanism is looking to achieve. This approach provides protection to consumers for any underspent allowances; however, further consideration is needed on what additional protection mechanisms are required to ensure the risk of using this mechanism is proportionate between consumers and TOs. One key area is the treatment of potential efficient overspends and abortive costs.

Given that the Totex Incentive Mechanism (TIM) does not apply to UIOLI allowances there is a risk that TOs will be fully exposed to any overspend or abortive costs for assets or activities that are initially progressed

under the UIOLI element of the APM, but then not ultimately allocated to a project or recovery route for the remainder of the cost. We propose that the APM reopener needs to provide a route for abortive costs to be recovered. This would be for assets or activities where the full cost is not covered by other regulatory mechanism (Reopener or Ex Ante Funding) and the APM spending cap has been breached. While this scenario will be unlikely, the potential exposure it creates is a significant concern with the mechanism as currently designed.

Q9. Do you agree with our proposal for the APM allowance to be capped at 20% of the estimated equipment cost?

We do not agree with Ofgem's proposal for the APM allowance to be capped at 20% of the estimated equipment cost.

The placing of 20% deposits is not reflective of the actual financial commitments TOs are required to make to secure equipment or the supply chain, with actual commitments varying between supplier, asset type and contractual conditions relevant to any specific project. In many instances TOs may be required to raise Purchase Orders for full contract value and/or enter into Capacity Reservation Agreements (CRAs) with varying cancellation curves/termination penalties.

If Ofgem retains a cap which is not reflective of the actual financial commitments the TOs are required to make then this will restrict our use of the APM, to:

- just those activities where we can have confidence that the APM will allow us to recover the actual financial commitments made (e.g. anything falling under the proposed cap); or
- for supply chain activities related to projects with regulatory approval of need, where we have certainty of an alternative route to recover the remaining value of financial commitment made (subject to efficiency assessment).

We understand Ofgem's driver is to reduce the potential exposure born by consumers by limiting the level of allowances that can be released through the APM; however, this must be balanced with ensuring the APM is designed appropriately to actually secure the supply chain and doesn't place disproportionate risk on the TOs.

Ofgem will be assessing the TOs planned supply chain activities when determining our first (and then subsequent) UIOLI allowance requests, giving it the opportunity to determine whether any proposed activities are deemed too risky to be allowed under the APM and alter our UIOLI allowance accordingly. Once the final UIOLI allowance has been determined, TOs should then have the flexibility to use their allowance for the range of activities outlined in their request, with all expenditure to be reported on and for reconciliation purposes as per Ofgem's current proposals. Final allowances will still be subject to an efficiency assessment at the reconciliation stage when full costs associated with delivery of specific investments are submitted for approval.

Q10. Do you agree with the use of a re-opener to update the APM in-period?

We believe the option to use both an annual reopener and Authority Triggered reopener to update our UIOLI allowance in-period should provide sufficient flexibility for TOs.

Q11. What are your views on our proposed approach to cost reconciliation?

We agree that a clear and transparent reconciliation of the allowances provided as part of APM, and allowances provided through other regulatory mechanisms is essential. This needs to be done while ensuring that the regulatory burden associated with the enhanced reporting and interactions with the wider reporting framework is manageable for both the TO and Ofgem. The level of work involved in delivering this reconciliation process across our internal systems, the Ofgem reporting templates and interaction can't be underestimated and the operation of the mechanism needs to be developed between Ofgem and the TOs to ensure information and cost information can be captured, tracked and provided in the form Ofgem require.

We are comfortable with the reconciliation process through cost/project assessments via uncertainty mechanisms (notwithstanding our comments in response to Question 8 in relation to routes for recovery of abortive costs and efficient overspend). However, for ex ante baseline projects, given the potential wider cost volatility within the RIIO-T3 period, within our recent RIIO-T3 Business Plan submission we have proposed a cost adjustment mechanism for our non-load portfolio. We believe that the reconciliation under the APM could be captured within this proposed mechanism and reflects cost movements from those set as part of the ex-ante baseline.

We agree that cost efficiency assessment should be conducted as part of the cost reconciliation process through the applicable cost assessment process. Ofgem note in paragraph 3.23 that in order to fairly assess cost efficiency they would compare market rates of equipment achieved by all three TOs and may look to create a cost benchmark that takes into account performance internationally. We have concerns that the approach of creating benchmarking on the asset costs procured via the APM can't be assessed as a siloed activity within the wider project costs. We believe this approach cherry picks the lowest cost of an asset and but does not account for the associated costs with delivery and installation, which may be higher than other cost points. It is the overall project cost that needs to be determined as efficient as part of the cost assessment process and, not cost approach on individual assets.

Q12. What are your views on how we should approach in-period updates to the APM?

We don't think it is necessary or beneficial for Ofgem to be overly prescriptive or restrictive on the list of equipment or activities ('services') eligible for funding through the APM. As explained elsewhere in our response TO utilisation of the APM should be reflective of what they need to procure when so will naturally only be used for either direct procurement of longer lead time equipment where this needs to be secured in advance of approval of project allowances, or to enable securing of the supply chain (contractors etc.) where it is beneficial to do this at an earlier stage before approval of project allowances.

Notwithstanding the above, we would be concerned that by adding or removing particular items from the scope of the APM will send misleading signals to the market about areas of prioritization for the TOs which could have a negative impact on our future contractual relationships with supply chain partners.

Q13. Do you agree with our proposal regarding retrospective application of the APM?

We believe Ofgem's proposal regarding retrospective application is proportionate and TOs should be able to use their first UIOLI request submitted in January 25 to outline any activities that have already taken place or are due to take place before the licence condition and subsequent access to allowances comes into effect.

Q14. Do you agree that the publication of detailed APM costs and volumes could be commercially detrimental to TOs, and by extension consumers? If so, why?

The data which will be recorded in the APM register will be equivalent to that provided by TOs through BPDTs and periodic reporting through the RRP which is not publicly available. We therefore would not expect the cost and volume data in the APM register to be publicly available. Publishing a list with volumes and forecast unit costs could weaken the TOs ability to negotiate with supply chain partners for the most efficient cost. Without additional context, volumes could be misleading and send wrong signals to OEMs. Volumes plus cost could also lead to misinterpretation of unit allowances/costs.

Ofgem should align the publication of any information in relation the APM allowances with what would be made publicly available in relation to any other regulated allowance.