

To: OnshoreCompetitionsPolicy@ofgem.gov.uk

Date: 01 December 2024

Dear OFGEM Onshore Competitions Policy team,

Consultation Response: Onshore ET EC commercial framework

Eclipse Power is pleased to respond to this consultation. For the most part, we think that the proposals from NESO make good sense, and note that in general, so does OFGEM. We have made observations in the responses below if we think that there could be improvements made.

It is clear from the various documents in the many consultations currently in progress from OFGEM and NESO, that delivering the huge amount of investment for Electricity Transmission will be a challenge. It is equally clear that the incumbent TOs, whilst they may ramp up their capabilities for RIIO-T3 to deliver new infrastructure and connections, they will not have the capacity to deliver this themselves. Bringing in the CATO concept will make a difference, providing that the conditions are attractive enough for investors. We believe that the proposals in this consultation should help in achieving this.

We remain of the opinion, discussed with OFGEM and NESO on many occasions over the last few years, that the Independent Transmission Owner concept would assist still further, particularly in the “last mile” connections market. We believe that this concept would complement the CATO proposals, and ask that it too be given due consideration.

Our response is non-confidential.

Responses to OFGEM’s Questions

1. Do you agree with NESO’s proposed approach to a CATO’s post-award security obligation?

Agree in principle, as a means of helping ensure that the CATO has a vested interest in progressing the project. Posting a security at 10% of the forecasted construction costs appears to be a good balance between retaining the attractiveness to investors and giving “sufficient consumer protection against non-delivery”. We agree that the tapering of the security from 100% to 0% as the project progresses is reasonable, as are the acceptable forms of security suggested.

2. Do you agree with NESO’s proposed approach to preliminary works payments?

We agree that some form of Pre-Construction Funding allowance is needed to create a more even playing field with the incumbent TOs, and that it should be the same for all bidders.

Payments are proposed to be non-mandatory, and only made where, “based on evidence from the market, (NESO) determines that payments to the CATO during the preliminary works period are required to help remove barriers to entry” (e.g. based on time or consenting complexity). We believe that the payments should be made in all cases, given that CATOs are likely to contain a significant element of new overhead line work, requiring an extended period of investment without return, and a high risk of delays in consenting. We observe that, especially in the case of Overhead Line projects, consenting effort will be dependent upon how successful the proposed (in the 2023 “Winser Report”) National Policy Statement and associated planning reforms approach has been.

We agree that payment should be linked to the achievement of specified milestones, which should be tailored to the specific needs of each project, justified by bidders, with evidence, in the ITT submission. As we understand it, this would then be similar to the PCF arrangements for the incumbent TOs.

We note that the NESO proposal links the cap value on payments to the forecasted cost of the indicative solution on the CSNP. The cap is proposed to be set at 50% of estimated PW costs. We agree that 100% would reduce the incentive to keep the project moving, but suggest that 75% would increase the incentive to invest as well as providing sufficient motivation to keep going. It would be useful to understand how accurate forecasts made by the incumbent TOs have been on recent similarly sized (non-CSNP) projects, especially since the PW cost estimates will initially, at least also come from these projects.

The approach suggested by NESO, and largely supported by OFGEM, is highly dependent upon the quality of CSNP data, and as OFGEM notes, the initial Early Competition candidates will be derived from the tCSNP, which may be worked up to a lower standard than the enduring CSNP.

We suggest that an override or waiver mechanism for some of the above limits may be needed if consenting gets bogged down, or if a project's complexity has been otherwise underestimated in the tCSNP/CSNP. If payments are not allowable for all projects, the waiver mechanism should also be available if a project is assessed by NESO as not requiring PW payments, based on the tCSNP/CSNP data, and this proves to have been significantly underestimated.

3. Do you agree with NESO's proposed approach to the PPCWA process?

Good that the potential for costs to change significantly during the preliminary works period is acknowledged, and that the incumbent TOs are not able to exercise an advantage. Use of indexation to handle the inflationary element is good. The proposed handling of unforeseen costs that could not reasonably have been included within the bid is much more challenging, recognising that it could take 4-5 years from submitting the bid before construction starts. This puts Early Competition CATOs in a significantly more onerous position than the incumbent TOs.

4. Do you agree with Ofgem's proposed adjustments to NESO's approach?

OFGEM notes that the proposed 40% cap on forecast costs presents bidders with the prospect of facing the full impact of unforeseeable costs beyond this, which is more onerous than the position for the TOs. OFGEM makes four suggestions in mitigation. We are satisfied that these are sensible and appropriate. However, we suggest that extending them to the first 3 tendered CATO projects, rather than just the first, will provide better evidence for adjusting and operating future tenders.

5. Do you agree with NESO's proposals regarding the payment mechanism and performance incentives to apply to a CATO?

We agree with the three key principles (comprising the TRS model, indexation, and availability incentives) which underscore the payment mechanism and performance incentives.

We query the proposed modification to the availability mechanism which uses Seasonality Factors. This is to incentivise planned outages when there are fewer network constraints, using a monthly weighting. Whilst agreeing that there is a need to plan outages at quieter times, we suggest that it would be better to link and refine this to the outage planning process from (say) 2-3 years ahead, which would then incentivise better planning, leading to optimised availability.

NESO proposes not to add a delivery incentive, as the deferral of the TRS until Commissioning should be sufficient, and as the delivery date will be driven by the CSNP, there will be not consumer benefit in delivering earlier. We agree on both counts.

We agree with NESO's view that equity gain share with consumers should not apply, in the event of an early sale, if the tendering process has been operated competitively. Bidders will set a return level that

“blends the project risks through design, construction and operation”. Profit in such circumstances would tend to reflect “how successfully the project has reduced the risk”. Gain share would effectively be penalising this, deterring some investors. This would reduce the key reason for introducing CATOs by limiting access to wider investment in Transmission.

We note OFGEM’s reluctance about gain share not applying, and “excessive profit” being made after the high-risk phase of a project. If the bidding process is truly competitive, and the investors’ required have been factored in through all phases of a project, then this presumably should not happen.

We suggest that maybe not having gain share and setting a minimum operational period of 5-10 years before allowing sales to be made could be a compromise here. We assume that investors in CATOs would naturally be happy taking a long-term view for their holdings.

6. Do you agree with NESO’s proposals regarding the additional works obligations?

We agree that a CATO should be subject to the Additional Works Obligation, probably from new connections rather than capacity increases. The type of projects being earmarked for Early Competition will have a clear (and probably enduring) network need, and will be in areas where there is unlikely to be another means for new connections to be made.

NESO’s phased approach to project design and additional works (post-award and pre-commissioning) seems reasonable.

Pricing additional works using a combination of CATO unit costs, indexation and design and build tenders appears reasonable and flexible.

We are concerned that the proposed self-funding for additional works up to 20% (and more so if up to 50%) has the potential for various factors to impact cumulatively here – if project costs are escalating as a result of challenges in gaining consent, as well as maybe unforeseen terrain or technical issues, and pushing towards the PPCWA cap, even an extra 20% to fund additional works could become a problem.

We take OFGEMs point about intergenerational fairness for funding using pass-through “fast money” payments, although it has a useful simplicity. Of the three, we would prefer a bespoke funding arrangement with OFGEM for significant additional works.

We agree with OFGEM that overall NESO has laid out practical proposals. We share their concern particularly around the pre-award challenges to accommodate additional works, and for the potential for multiple connection requests to overstretch a CATOs ability to respond. Unlike the incumbent TOs, a CATO will only have limited technical and commercial resources at its disposal, and as such it would be unreasonable to put the same obligations on them as a full TO.

7. Do you agree with NESO’s proposals regarding the revenue period and end of revenue process?

We acknowledge that 35-year revenue period could be difficult for a bank (preference for around 20 years). Other bond providers could do this, but on “less flexible terms”, so the CATO should undertake assessment of alternative financing structures as part of their debt funding competition following preliminary works.

We appreciate the concerns, in particular regarding the passing of refinancing risk onto consumers, and agree that some form of refinancing gain sharing is a possible way forward, providing that this is not unduly prejudiced against investors.

Revenue Period

We agree that the TRS should align with expected physical asset life rather than “network need”, which as noted in the EC-I update will probably be “enduring”. Applying a 40-year asset life (the likely life expectancy for onshore overhead lines) is therefore reasonable. Similarly, the assumptions about needing to undertake major interventions (and reinvestment) at around the 35-year mark if the asset

life is to be extended beyond 40 years, and linking the revenue period end point to that, are also reasonable.

By setting the TRS over 35 years, and the depreciation period to 40 years, there will be 5 years of residual value at 35 years. Agree that this is reasonable, as it incentivises the CATO to keep its assets in good health.

End of revenue period

We agree with NESO's proposals for what happens at the end of the revenue period. This includes the 30-year mark "network need and asset health check", which will drive the three potential outcomes for ongoing network need at 35, 40 and 40+ years.

We agree that asset health is a key issue, particularly for an enduring need beyond 40 years. The asset condition is to a significant extent a function of the maintenance strategy provided at bid submission, as well as environmental factors for the location of the asset (e.g. proximity to the sea, or exposure to wind).

Revenue Stacking

We concur with NESO's reservations about the ability to accommodate revenue stacking. The complexity of unpicking multiple revenue source contractual arrangements is likely to be too high, given the increased possibility of asset transfer or re-tendering.

Asset Transfer

We note NESO's proposals regarding the ability to transfer assets, including when following a termination, make more sense than the original ECP proposals, and with the compensation on termination proposals, may make investment more attractive.

Kind regards,

Bill Scott

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