

Minister for Business, Energy and Tourism  
Fergus Ewing MSP



T: 0300 244 4000  
E: scottish.ministers@gov.scot

Dermot Nolan  
Chief Executive  
Office of Gas and Electricity Markets  
9 Millbank  
London  
SW1P 3GE



11<sup>th</sup> January 2016

Dear Dermot,

**Extending competition in electricity transmission: proposed arrangements to introduce onshore tenders – Ofgem consultation 19 October 2015**

I enclose the response of the Scottish Government to the above consultation concerning arrangements to extend competition in electricity transmission to onshore networks in Great Britain. We touched on this issue briefly at our last meeting and I welcome the opportunity to respond now in greater detail.

The electricity sector is a major component of the Scottish economy and one in which the Scottish Government takes a keen interest. High-quality investment in energy generation and the transmission system plays a vital role in delivering cost-effective supply for customers, facilitating the transition to a low carbon economy and supporting growth and employment in Scotland.

The potential exists to reduce customer bills by encouraging more cost-effective network development, increasing transparency and incentivising greater innovation in financing and design through competitive tendering of future network developments. Individually and collectively these are commendable objectives, although I would welcome further information on the scale of consumer benefits Ofgem hopes to achieve.

Nonetheless, the introduction of competitive tendering through the proposed early and late Competitively Appointed Transmission Owners (CATO) models represents a major shift in how GB electricity transmission is regulated and operated. It is therefore imperative that the change is designed and implemented in a manner that supports the attainment of the proposed benefits while mitigating potential drawbacks and risks. This is a pre-eminent concern of the Scottish Government given the likelihood that the geographical impacts of competitive tendering will be concentrated in Scotland at least up until 2021. The concentration of initial impacts in Scotland is not highlighted in the consultation document.

While we are supportive of the principle of increasing competitive pressure on the development of the transmission system, we have some significant concerns about the effects of the proposals and their practicality that need to be worked through. The key points are summarised in the attached response alongside responses to selected questions posed by the consultation.

We look forward to working with Ofgem and our wider stakeholders in the coming year to address these issues and together find workable solutions that will support the development of an efficient, co-ordinated and economical system of electricity transmission while realising the potential benefits of ITPR for consumers.

Yours Sincerely

A handwritten signature in black ink that reads "Fergus Ewing". The signature is written in a cursive style with a large loop under the 'F' and 'E'.

**FERGUS EWING**

# **OFGEM CONSULTATION – EXTENDING COMPETITION IN ELECTRICITY TRANSMISSION: PROPOSED ARRANGEMENTS TO INTRODUCE ONSHORE TENDERS**

## **SCOTTISH GOVERNMENT’S RESPONSE – OVERVIEW**

### **Introduction**

Ofgem has decided to introduce competitive tendering for new, separable and high value onshore electricity transmission assets and is consulting on the arrangements for this.

The Scottish Government has reviewed Ofgem’s consultation and engaged a range of stakeholders to develop a rounded assessment. This response is in two parts: first, this overview section; and, second, a series of responses to specific questions posed by the consultation document.

We share Ofgem’s wish to accelerate investment in transmission infrastructure and bear down on system costs. We support effective competition in the energy sector in principle and see benefits in attracting new resources to construct and operate transmission assets, lessening reliance on a single transmission owner (TO) to deliver all reinforcements within a given territory.

The construction of transmission infrastructure is, of course, highly sensitive for many communities so any new regulatory regime must produce a streamlined planning and consenting process that builds trust and confidence across stakeholders whilst supporting timely delivery.

The Scottish Government anticipates further work with Ofgem and key stakeholders to develop the detailed arrangements necessary for the successful implementation of onshore tenders. We are aware that during 2016 DECC will publish a cost-benefit analysis and Ofgem will hold further workshops to determine how tendering will operate in practice and how the Competitively Appointed Transmission Owners (CATOs) will be effectively regulated. We welcome both these developments and hope to be able to contribute further.

### **Ofgem’s objective**

The introduction of onshore tenders is designed to achieve better value for consumers by putting competitive pressure on costs. This will incentivise cost-effective network development and increase visibility of costs, while allowing for innovation by new participants who have strong technical and delivery expertise.

The Scottish Government supports Ofgem’s aim of reducing the costs of constructing and operating electricity transmission assets and welcomes the intention to strengthen innovation and improve efficiency in providing customer connections. We support initiatives that can generate long-term benefits for customers of the transmission system and want to see any cost savings translate quickly into lower energy bills for businesses and households.

Competition alone in the energy market has not always been sufficient to deliver the best outcomes for consumers and Scottish Ministers believe competition must be supported by robust, rigorous and effective regulation.

## **Economic impacts in Scotland**

Ofgem's plans for onshore competition as outlined in the consultation – during the RIIO-T1 phase in particular<sup>1</sup> – will impact Scotland disproportionately. This flows from Ofgem's decision to restrict projects open to tender during the RIIO-T1 price control period to Strategic Wider Works (SWW) and the different value thresholds set for SWW in the three onshore transmission areas.<sup>2</sup> Due to the £500m threshold for SWW in England and Wales, the majority of competed projects in the initial tenders up to 2021 will be in Scotland. The Scottish Transmission Operators (TOs) will therefore be differentially exposed to competition compared with their counterpart with responsibility for England and Wales, National Grid Electricity Transmission (NGET). In the Ofgem Factsheet No.125 'Strategic Wider Works' November 2013, 11 of the 12 projects identified as SWW are located in Scotland.

The geographical concentration of impacts in Scotland is not acknowledged in the consultation. This failure to recognise the geographical dimension of likely impacts – or by extension the knock-on impacts on the Scottish economy and the policy aims of the Scottish Government – is an unfortunate omission. We believe further consideration must be given by Ofgem to this point before proceeding.

The electricity sector is a major component of the Scottish economy with renewables the single largest contributor to electricity generation in Scotland. In 2014 renewable sources generated 49.7% of total Scottish electricity consumption, with Scottish renewable generation making up approximately 29% of total UK renewable generation.<sup>3</sup>

The Scottish Government has ambitious targets on renewable energy and climate change that will be underpinned by a transition to a low carbon economy. This includes a commitment to meet the equivalent of 100 per cent of electricity demand and 11 per cent of heat consumption from renewable resources by 2020<sup>4</sup> and to reduce Scotland's emissions of greenhouse gases by 42 per cent by 2020 and 80 per cent by 2050.

Electricity generation and associated transmission investment also makes a significant contribution to growth and employment in Scotland – particularly in many remote and less heavily populated parts. In 2014, 21,000 people were employed directly in the low carbon and renewable energy economy in Scotland.<sup>5</sup>

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<sup>1</sup> RIIO-T1 operates from April 2013 until March 2021.

<sup>2</sup> In England and Wales Strategic Wider Works have a value threshold of £500m or above, £100m in the transmission area of SPTL and £50m in that of SHE-T.

<sup>3</sup> The Scottish Government, *Energy Statistics for Scotland*, December 2015.

<http://www.gov.scot/Resource/0049/00491539.pdf>

<sup>4</sup> The Scottish Government, *2020 Routemap for Renewable Energy in Scotland*, July 2011

<sup>5</sup> The Scottish Government, *Energy Statistics for Scotland*, December 2015.

<http://www.gov.scot/Resource/0049/00491539.pdf>

The Scottish Government promotes the transition to a low carbon economy and is committed to promote high-quality investment in energy generation from renewables and enable investment in the transmission system necessary to transport that energy to consumers across Great Britain. The Scottish Government welcomed Ofgem's decision in 2012 to fast-track £7 billion of investment in Scotland's high voltage network over 2013-21 as set out in Ofgem's RIIO-T1 price control. This investment is helping to maintain a reliable and secure network at a fair price for customers while meeting the investment challenges arising from the transition to a low carbon economy.

Given that Ofgem has recognised the scale of the electricity industry in Scotland and the need to fast-track development, along with the Scottish Government's commitment to energy and climate change goals, Scottish Ministers require assurance from Ofgem that Scotland will suffer no adverse effects from the introduction of competition. How Ofgem decides to phase and manage its approach is critical to ensure that benefits are realised for Scotland's economy and all GB consumers.

### **Success criteria**

To be judged successful over the long-term, competition needs to accelerate investment and connections; reduce whole system costs; enable wider market participation; release new resources for system planning; enhance relationships with communities and promote a level playing field across the GB market.

The consultation document and supporting material do not offer the necessary degree of assurance that these success criteria will be met. They do not establish a clear view on the level of benefits likely to be achieved over the whole lifetime of transmission projects nor do they formulate a complete view of the risks and potential drawbacks of moving to CATOs.

We have some significant concerns, for example, about: (i) the potential impact that the CATO process will have on delivery programmes for much-needed transmission reinforcements such as connections to the Scottish islands; (ii) limited evidence of cost savings, (iii) the potential for fragmentation to incrementally increase system complexity and cost; (iv) the scope for innovation beyond merely financial innovation; (v) the ambitious timeframes for developing / implementing the CATO process and (vi) public engagement and accountability.

### **Potential to lengthen delivery timescales**

The CATO process is considered likely to increase the overall project delivery timescales for Scotland, due to the differences in the planning and consenting regime in Scotland compared to England and Wales.

In England and Wales, Development Consent Orders are a typical mechanism for delivering strategic projects. The planning process for nationally significant infrastructure projects, or 'NSIPs', was established by the Planning Act 2008 ('the 2008 Act'). NSIP planning applications are made to the Planning Inspectorate for

decision by the relevant Minister providing a streamlined process and avoiding multiple local authority consultations and applications. The Planning Inspectorate also provides a support and advisory role and publishes guidance on NSIP applications. The DCO consent combines a grant of planning permission with a range of other separate consents, such as listed building consent and including rights to compulsorily purchase land. There are also special procedures relating to cases such as commons, National Trust land, and land protected under the Green Belt. Within a proposed NSIP DCO application, it is also possible to incorporate relevant associated development. The Planning Inspectorate works to statutory timescales and advise from accepting an application to making a decision, the whole process should last in the region of 15 months.

In Scotland all proposed developments sit within one of three categories (National/ Major/ Local) within a statutory hierarchy of development. National developments are designated in the National Planning Framework for Scotland, approved by the Scottish Parliament defining the necessity of these developments. Any objection to an application for a national development can only be made on an issue of detail (specific proposals / route alignments / mitigation), as its inclusion in the National Planning Framework for Scotland 3 is deemed to have established the need for that development. Whilst national development status establishes the need for a project, it does not grant development consent. Section 37 consents and any wider planning permission / other necessary consents and assessments are still required.

The Scottish Government is concerned about potential impacts on key Strategic Wider Works (SWW) projects, in particular those where preliminary work has already commenced or where needs case preparation has reached an advanced stage.

No undue risk of delay to delivery of works due to the introduction of onshore tenders would be acceptable to the Scottish Government. SHE Transmission, Ofgem, DECC and the Scottish Government have been working towards a process that enables SHE Transmission under the current regulatory arrangements to deliver the island links within a timescale that is compatible with the wider policy (CfD) support and developer requirements.

We therefore welcome and fully support the commitment by Ofgem to take into consideration – alongside the criteria for tendering – the potential for tendering to impact negatively upon deliverability. We note that Ofgem has outlined in a correspondence with the Scottish Government, 17<sup>th</sup> December 2015, that it “*will not tender those projects if there would be a material adverse impact on the project, including on timing.*”

### **Limited evidence of cost savings**

The claims of potential cost savings from the CATO regime for onshore transmission are not well substantiated within the evidence provided; they rely exclusively on one early report prepared for Ofgem by CEPA/BDO<sup>6</sup> of the benefits of the first round of

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<sup>6</sup> *Evaluation of OFTO Tender Round 1 Benefits* – a report for Ofgem prepared by BDO/CEPA (May 2014):[https://www.ofgem.gov.uk/sites/default/files/docs/2014/05/140508\\_covering\\_letter\\_to\\_cepa\\_report\\_final\\_for\\_publication.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/2014/05/140508_covering_letter_to_cepa_report_final_for_publication.pdf)

OFTO tenders. The authors of that report themselves conclude:

*“there are limits as the extent to which lessons can be drawn for the onshore electricity transmission network. The results are context-specific to TR1...”*  
and *“...caution is warranted in terms of any comparisons with the wider onshore electricity transmission regime...”*<sup>7</sup>

Further, the CEPA/BDO report states the savings available on financing costs (identified as a key potential benefit within the consultation) between the OFTO regime and the price control counterfactuals are small. Total savings of £8 million and £17 million (Net Present Value) were identified across all Tender Round 1 licences over 20 years within the relevant two counterfactuals.

The assumptions stated in the report about financing cost show that the calculated numbers are *“based on what Ofgem could reasonably have expected to have achieved at the time and subsequently over the life of the assets.”*<sup>8</sup> In the context of the overall capital commitment (c. £4 billion) these figures appear relatively marginal.

The OFTO regime is relatively immature with only two completed tender rounds to date which have delivered radial transmission network additions forming ‘dead end’ spurs to the existing transmission and distribution networks where any further development of the assets is unlikely. The onshore network is a different environment being substantially interconnected where potential CATO projects may be subject to future variation (e.g. for extensions, upgrades, new connections). This requires a high level of coordination and optimisation of interacting network developments and future-proofing to ensure appropriate up-front design and expenditure to optimise against risks and costs and hence keep the ultimate costs to consumers down. Therefore, any extrapolation of estimated benefits from the OFTO regime to onshore transmission must be subject to huge uncertainty and therefore treated with a high degree of caution.

The Scottish Government considers that other avenues of potential savings should be considered further alongside the proposed CATO arrangements. Any identified benefits or risks from the CATO arrangements should be compared against the alternatives including potential financing savings that could be made by modifying the price control arrangements for the incumbent TOs. Overall, the range of options to reduce transmission costs has not been adequately covered to justify the choice to take forward the CATO model now in the manner proposed by Ofgem.

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<sup>7</sup> Ibid., p 10

<sup>8</sup> Ibid., p 5

## **Cost benchmarking**

The Scottish Government acknowledges that the introduction of competitive tendering for onshore transmission has the potential to reveal greater information on costs, and that this transparency may help to provide further regulatory benchmarks to measure costs and performance of both TOs and CATOs. However, we would be concerned about any over-reliance on the use of benchmarking data and market tests to ensure that costs are economic and efficient.

Ofgem should continue to scrutinise TOs costs (and those of future CATOs) independently from the benchmarking data in order to continue to make a rounded assessment of value for money for consumers. Competition alone in the energy market has not always been sufficient to deliver the best outcomes for consumers and Scottish Ministers believe competition must always be buttressed by robust, rigorous and effective regulation.

Experience of some of our stakeholders from OFTO cost assessment processes is that benchmarking needs to be undertaken and used with care to ensure like-for-like comparisons are achieved. Within the OFTO regime, all connections that have been developed to date are broadly comparable – point to point links connecting a single offshore substation to a single onshore substation. Market analysis across the OFTOs is therefore relatively simple. Even still, attempting to boil the analysis down to broad, system-wide metrics (e.g. £/MW, £/km) can often result in an incomplete or inaccurate understanding of costs as each individual project has project specific constraints and issues (e.g. varying installation conditions, contracting structures, supply chain issues, site specific plant and different voltages etc).

## **System fragmentation – complexity, increased cost and risk**

The Scottish Government is concerned that there may be additional costs associated with increasing system fragmentation and the number of interfaces on the transmission system that has not been accounted for appropriately within the impact assessment. These additional costs may be significant over the lifetime of the assets and must be better understood in weighing costs and benefits. Additional interfaces would complicate transmission owner's/system operator processes adding both additional time and risk as well as cost. For example:

- Additional parties that are required to study and coordinate with respect to system outages, planning of activities, dealing with emergencies, network development, system studies, new connections etc.
- the securing of Necessary Wayleaves under Schedule 4 of the 1989 Electricity Act are granted to the licence holder and if there is a change in asset owner the new licence holder must re-apply, or
- multiple consultations, scoping and related studies with statutory and other bodies in pre-application and pre-route alignment studies.

Fragmenting ownership of onshore transmission could have undesirable implications for customers seeking to connect to the network. When applications to connect to the transmission system are made, all affected transmission owners must assess the potential impacts. Increasing the number of transmission owners could result in



higher connection application fees as more parties are required to be consulted and network impacts assessed. Further, the standard three-month process to make a connection offer may be lengthened.

## Planning and consenting differences

The planning and consenting systems of Scotland and of England and Wales have many similarities but there are significant differences between them which lend complexity to introducing competition to onshore transmission projects. This issue is important as 11 of the 12 Wider Strategic Works projects for potential early consideration are situated in Scotland.<sup>9</sup>

The key planning and consenting differences relate to Scotland's Section 37 Consent Procedures; the non-applicability of Development Consent Orders (DCOs); the transferability of land rights with consents; and a wider commitment to inclusive public and stakeholder engagement within the Scottish consenting process<sup>10</sup>.

The commitment to engagement is set out within SPP<sup>11</sup> - see the "Core Values of the Planning Service" and "People Make the System Work" - that specifically commit to an inclusive planning system based on engagement providing opportunities for everyone to engage in the development decisions which affect them. The SPP notes that, "*effective engagement can lead to better plans, better decisions and more satisfactory outcomes and can help to avoid delays in the planning process*".

The Planning etc. (Scotland) Act 2006 and associated secondary legislation provide enhanced opportunities for people to get involved in the planning system. (See Planning Advice Note 3/2010 Community Engagement<sup>12</sup>.) The Government's policy on community engagement is set out in Scottish Planning Policy (SPP) and in relevant Planning Circulars such as Circulars 1/2009: Development Planning and 4/2009: Development Management Procedures. This PAN provides advice to communities on how they can get involved and advice to planning authorities and developers on ways of effectively engaging with communities on planning matters. The PAN also links directly with the National Standards for Community Engagement.

Engagement is also a requirement within the securing of wayleaves. The application process to secure wayleaves<sup>13</sup> expects licence holders to involve people in the decisions that affect them.

At present, consenting and delivery processes for transmission are highly inter-dependent and successful delivery has been achieved to date through close coordination of a limited number of players working within a close and committed

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<sup>9</sup> Ofgem Factsheet No.125, Strategic Wider Works, November 2013.

[https://www.ofgem.gov.uk/sites/default/files/docs/2013/12/strategic\\_wider\\_works\\_factsheet\\_0.pdf](https://www.ofgem.gov.uk/sites/default/files/docs/2013/12/strategic_wider_works_factsheet_0.pdf)

<sup>10</sup> Note: Scottish Ministers are currently undertaking a review of the Scottish planning system which is due to report in March 2016. The review is driven by the objective of continuing to secure the best alignment of our planning and consenting regimes with sustainable economic growth and the delivery of societal benefits.

<sup>11</sup> Scottish Planning Policy June 2014 - <http://www.gov.scot/Publications/2014/06/5823>

<sup>12</sup> Planning Advice Note 3/2010 Community Engagement

<http://www.gov.scot/Publications/2010/08/30094454/2>

<sup>13</sup> Necessary Wayleaves guidance for applicants, landowners and occupiers. April 2014

dialogue with all stakeholders. The proposed changes will introduce new participants and change the dynamics around the SO / TO / and CATO roles and if the added complexity and engagement processes is not to introduce consenting risk, formal protocols for stakeholder engagement will need to be established and managed.

### **Securing the benefits of competition**

Ofgem's consultation does not establish a clearly defined, streamlined and effective management process – that is, a clear framework, systems and protocols with the appropriate leadership to drive the desired outcomes. Without this, we foresee significant risks to the delivery of key transmission infrastructure projects which could negate the immediate cost benefits secured through competitive tendering.

Our assessment of the two tender models – early CATO build and late CATO build – based on information detailed in the consultation highlights:

- real concerns with the delivery of the early CATO model in Scotland around the role of the SO and clarity around securing the resource to provide a structured and accountable framework to co-ordinate delivery and quality; and
- for the late CATO model (the only practical option in the near-term) a need to clarify assignments and arrangements for transfer of land rights.

In developing this response, we have taken soundings from regulatory bodies and other key consultees<sup>14</sup> on potential issues relative to their individual responsibilities. Broad consensus emerged around the importance of:

- adequate resourcing and leadership for the enhanced System Operator's (SO) role from staff based in Scotland with capacity and skills to manage the transition and set the framework with the TOs for the new system;
- setting within the consenting process mechanisms that recognise the difficulties within EIA (including the new EU Directive) on the consenting of broad corridors and planning envelopes;
- developing systems, standards and design guidance to drive an effective, highly streamlined consenting process which facilitates faster-delivery whilst enabling engagement, quality in delivery and innovation, and
- addressing the challenges of securing transferability of property rights with an anticipated need for amendments to current legislation.

### **Points requiring further Ofgem consideration**

#### References to consenting processes

References in the consultation document to the consents process are frequently less than clear (See Figure 1-3 of the Ofgem Consultation document) and suggest a

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<sup>14</sup> SNH, SEPA, Historic Environment Scotland, Marine Scotland and RSPB.

reliance on the DCO Procedure and/or a lack of detailed knowledge of current Scottish practice covering engagement (statutory bodies and public), legislative requirements (EIA assessment application) and the sequencing of elements to ensure a streamlined consent process.

### Transfer of property rights

Section 37 consent does not provide for transferable land rights to the consent owner /licence holder. Land rights (including necessary and voluntary wayleaves, servitudes and Compulsory Purchase Orders) are a major issue for project delivery in Scotland (resources / programme / risk) and have the opportunity under current legislation to significantly impact on project programmes.

A Necessary Wayleave<sup>15</sup> is a statutory right which confers powers on the licence holder to install and maintain transmission lines and associated equipment on, over or under private land. The Necessary Wayleave will remain in force for the period specified and is enforceable by the licence holder against subsequent landowners or occupiers, if the land is sold or the occupant changes during the period. However Necessary Wayleaves are acquired and held by a named licence holder under Schedule 4 of the 1989 Electricity Act and if there is a change in licence holder the new licence holder must apply again for a Necessary Wayleave.

The procedures for Application to the Secretary of State for Energy and Climate Change for the grant of a Necessary (Compulsory) Electricity Wayleave or Felling and Lopping of Trees Order in England and Wales (January 2014)<sup>16</sup> does not apply in Scotland. The hearing process is governed by the Electricity (Compulsory Wayleaves) (Hearing Procedure) Rules 1967 and Planning and Environmental Appeals Division of the Scottish Government.

This means that for a late CATO build if the SO/TO applies and is granted a Necessary Wayleave once the consent is granted and the late CATO is appointed these Necessary Wayleaves would need to be applied for again. This would create significant duplication and impact on cost and programme. Alternatively, the SO/TO may not secure any Necessary Wayleaves and the appointed late CATO makes application for wayleaves once the Consent has been granted and assigned. This also creates delay as the appointed CATO would be restricted to commencing work on land that had been acquired through voluntary or any other agreements. (Average process time for a Necessary Wayleave is currently 15 months).

Ministers must have regard to the extent to which the Necessary Wayleaves have been agreed and take into account any prejudicial effect any decision on the Section 37 application may have on any subsequent proceedings relating to the outstanding wayleaves.

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<sup>15</sup> Applications to The Scottish Ministers for The Grant of a Necessary Electricity Wayleave in Scotland <http://www.gov.scot/Resource/0044/00447590.pdf>

<sup>16</sup> Application to the Secretary of State for Energy and Climate Change for the grant of a Necessary (Compulsory) Electricity Wayleave or Felling and Lopping of Trees Order in England and Wales (January 2014)

Given the critical programming implications of the transfer of property rights, DECC should give consideration to the legislative framework going forward and the impact of this on current projects which are being brought forward under SWW where lands rights and voluntary wayleaves are already under negotiation.

#### Enhanced System Operator role

The Scottish Government supports the development of an enhanced SO role but has concerns that Ofgem perhaps see this as a management role limited to the definition of need rather than one which provides leadership and enables and drives the design, consenting and delivery programme. We do not consider that the structure proposed by Ofgem currently provides assurance or clarity on these matters and feel that more consideration should be given to an Independent System Operator (ISO).

#### Developing systems, guidance and protocols

There are successful examples of infrastructure delivery models (e.g. transportation sector) that highlight the value of a strong sponsor organisation with clear responsibility to advance delivery, secure innovation and establish a clear and competitive tender process. We consider that an extended SO, potentially operating as an independent system operator, could drive forward this process, reduce the potential for conflicts of interest and support a commitment to engagement coupled with independent audit. The consultation document refers to a need for 'high quality' and 'robust' preliminary works – but it is unclear how accountability, quality and warranty issues would be addressed without a significantly stronger SO role.

## CHAPTER 2: WHAT WILL BE SUBJECT TO COMPETITION AND HOW WILL WE IDENTIFY THOSE PROJECTS?

### **Question 1: What are your views on the proposed detailed interpretations of new, separable and high value (the ‘criteria’)?**

Ofgem has decided through the Integrated Transmission Planning and Regulation (ITPR) project to increase the role of competitive tendering where it can bring value to consumers. This will include the use of competitive tendering for onshore transmission infrastructure projects that meet the criteria:

- *new* (or complete replacement)
- *separable* (where ownership boundaries and responsibilities for particular assets can be delineated), and
- *high value* (worth £100 million in capital expenditure or more).

During the RIIO-T1 price control period (April 2013 until 31 March 2021) any tendering would be restricted to projects meeting the definition of SWW<sup>17</sup>; beyond RIIO-T1 Ofgem expects to tender all new, separable and high value transmission investments.

While the criteria themselves appear reasonable the Scottish Government is concerned about the focus on SWW projects and the meaning of separability as it relates to planning, consenting and delivery.

#### Effect of focussing on SWW projects

The proposed restriction of tendering to only SWW projects until 2021 has the unfortunate consequence of narrowing the geographical scope of competition (that is, almost exclusively to projects in Scotland) while also creating an imbalance in exposure to competition for Britain’s three transmission owners. The portfolio of National Grid Electricity Transmission (NGET), the largest of the three transmission owners, would be exposed to the least competition.

The basis of the restriction to SWW projects is open to challenge on several grounds, including that: (i) the threshold is arbitrary, (ii) it creates unevenness in competitive pressures across the incumbent TOs, (iii) it appears to restrict potential consumer benefits and (iv) it will tend to concentrate some effects – for example, any adverse impacts on delivery of new assets and connections in Scotland.

It could be argued that Ofgem’s position does not best reflect the interests of consumers who stand to lose out on potential savings and benefits from a large suite of projects (valued at between £100-500 million) to be progressed under RIIO-T1 in England and Wales.

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<sup>17</sup> The value threshold for Strategic Wider Works under RIIO-T1 in England and Wales is £500 million (for National Grid Electricity Transmission) set against £50 million (for Scottish Hydro Electric Transmission plc) and £100 million (for Scottish Power Transmission Limited)

## Separability in planning, consenting and delivery

The Scottish Government notes that the consultation deals with separability in terms of transmission assets but we would highlight that under the consenting regimes (EIA, Habitats Directive etc), projects need to be considered holistically regardless of asset owners. The new EIA Regulations specifically strengthen the requirement to avoid sub-division of schemes / multi-element consenting and require a fuller assessment of cumulative impacts and alternatives. Statutory consultees noted the importance to consenting timescales of the robustness of EIA and clarity of mitigation proposals based on well-defined scheme proposals.

### **Question 2: Under what circumstances do you think asset transfer from an existing asset owner to a CATO would be required, recognising the principle that projects identified for tendering should be new?**

Ofgem envisages that in some circumstances, in order to develop a project effectively, particular assets (e.g. preliminary works or land) may have to be transferred from the incumbent transmission owner to the CATO.

It is important that any asset transfer process does not result in delays to the overall delivery of new infrastructure. Experience with OFTOs has shown that transfer of assets can on occasion be complex – resulting in issues that are difficult to resolve without protracted asset transfer negotiations. These can be difficult to foresee ahead of time as they can tend to relate to technical issues. Therefore, a clear process, ideally with fixed timescales, should be implemented. The timing and phasing of this process should be made clear and, if possible, paralleled with other parts of the process to minimise its impact on delivery.

There is a need for Ofgem to note the transferability of Necessary Wayleaves which currently confers rights to a named licence holder. Necessary Wayleaves are acquired and held by a named licence holder under Schedule 4 of the 1989 Electricity Act and if there is a change in asset owner (licence holder) the new asset owner must apply again for all Necessary Wayleaves relating to the asset.

### **Question 3: What are your views on our proposal that electrical separability should not be required at each interface, but that the system operator can propose it to us if it thinks there is a cost-benefit justification based on system operability?**

Separability is one criterion for competition – that is, the ability to delineate ownership boundaries and responsibilities for particular assets – but that is distinct from *electrical separability*. Electrical separability will not be required for a project to be tendered under the proposals of the consultation.

The Scottish Government agrees that electrical separability is not necessarily required at each interface. Nonetheless, the need for appropriate electrical isolation and coordination is important for outage planning and therefore has an impact on the issues associated with system coordination, availability and complexity – discussed below.

**Question 4: What are your views on the suggested process and roles for identifying projects for tendering? We have proposed specific roles for the system operator – do you think there are any additional roles the system operator could take on to support competition? What’s the most appropriate way to ensure that the network options assessment (NOA) considers the widest range of network options, including those that would be tendered?**

For the RIIO-T1 period Ofgem will identify projects for tender from the transmission owners’ SWW submissions (needs case or initial project reports) with reference to the tendering criteria, work already undertaken by the incumbent TO and the effect of tendering on the timing for delivery.

In the medium to longer term, the System Operator (SO) will be responsible for identifying projects for tendering and for doing the early development works before a project is tendered. This would be done by the SO through the new network options assessment (NOA) process which identifies the needs of the transmission system, options to meet those needs, and recommends the best approach.

The Scottish Government’s initial key concern in this area relates to the clear potential for delayed delivery of planned RIIO-T1 transmission assets and associated knock-on impacts for the energy sector in Scotland and the Scottish Government’s energy and climate change objectives. For many projects tendering could introduce additional delays into the process of delivering transmission reinforcements that already demonstrate clear and justified need. The consultation document acknowledges the potential of tendering to impact upon the timing of deliverability of projects but is silent on how this key consideration will be weighed in the identification process. This is an omission that needs to be clarified quickly.

In the longer term, the enhanced SO role in Scotland needs to be developed and monitored by Ofgem to ensure that NOAs are correctly identified and there is effective cooperation between the incumbent TOs, CATOs and the SO in the identification of system needs. There needs to be cooperation and sharing of information between Ofgem and the Scottish Government to ensure that Scottish Government energy policy aims are supported and not adversely affected by the transition to an enhanced SO.

#### Enhanced SO role – planning and consenting

Beyond the RIIO-T1 period, there is a need to ensure that the SO role is properly resourced with capacity and skills in Scotland. We envisage additional pressures on regulatory bodies during transitional arrangements that need to be managed particularly in the Early CATO model. For example; multiple requirements for pre-application and/or pre-CATO appointment consultations and scoping opinions from

statutory consultees and key bodies that would support CATO submissions. These could be envisaged to include a range of alternative high level project strategies from differing and competing CATOs e.g. system strategies / alternative route alignments / alternative grid reinforcements / grid connections / undergrounding etc.

Under the current arrangements the Scottish Government and key regulators have limited interaction with NGET in its role as System Operator.

In relation to the NOA process, it would be appropriate to ensure the sustainable development of the network and therefore the need within NOA to consider high-level economic, social and environmental factors impacting on delivery as part of the options appraisal.

### Defining SO/TO/CATO Roles

The NOA will identify the need for projects and presumably a timescale under which projects will be advanced. The NOA will be a public document and will create a profile for projects and initiate interest for engagement and consultation from stakeholders and the public.

Who will have responsibility for initial stakeholder engagement and who will oversee engagement and handovers at various project stages is unclear to us. SO / TO and Ofgem will need to have the capacity and defined responsibilities to address stakeholder and public engagement at all stages. We note further that these roles may change through the implementation process with SOs / TOs becoming CATOs and thus raising issues of continuity and trust within the engagement process.

### **Question 5: What incentives and obligations should the system operator and transmission owners have for undertaking preliminary works for tendered projects, and is there any value in considering a success fee incentive?**

The consultation states that preliminary works – such as site surveys, environmental assessments, planning permissions and consents – need to be undertaken effectively in order for there to be a successful tender and ultimately robust and efficient transmission assets. The Scottish Government agrees that this is crucial.

### Obligations – Standards associated with consenting

Ofgem is yet to provide sufficient clarity around preliminary works and responsibilities within the two CATO models (Figure 1 of the consultation document refers). Critical to success of consenting and delivery is ensuring all pre-consent preliminary works are of high quality against established standards and design guidance – including survey work scoped and undertaken in consultation with regulators.

A need exists to develop and have in place systems, standards and design guidance to drive the delivery programme and ensure quality and innovation through procurement, design and environmental performance. Stakeholder engagement is a particularly important element in consenting (see SPP 'Core Values of the Planning



Service' and 'People Make the System Work')<sup>18</sup>. It will be important that engagement obligations (e.g. with the Scottish Government / regulatory authorities / stakeholders / landowners and the public) and standards are defined clearly and consistently applied. The consultation document gives no indication of how this process would operate.

Successful operation of the CATO process requires the timely and secure transfer of robust and reliable information between the SO / TOs and CATOs. All such documentation needs to be capable of reliance and audit. Assignable warranties that allow each interest reliance on information prepared by others will be required to support funders/SO/TO/CATO and others. Poor information exchange or poor quality studies, which might necessitate duplication, will adversely impact programmes. We believe there will be a need for clear assignable collateral warranties<sup>19</sup> to ensure all parties can have full commercial reliance on information supporting consenting.

In our view, the application of rigorous standards and quality control processes offer a stronger and more robust and accountable framework for consenting than incentivising early participants through success fee incentives.

**Question 6: Should CATOs pay for the preliminary works at the point of transfer?**

We do not have a position on the most appropriate time for payment for preliminary works transferred. However, we foresee a significant challenge in determining the correct value of preliminary work packages and limiting conflicts of interest where the SO/TO is also a CATO tenderer.

The value of preliminary works may be highly variable and difficult to assess. CATOs introducing change and innovation may, by reasons of their approach / routing/ design, not have need for preliminary studies or consider them of limited value due to relevance (time / extent / specificity).

Preliminary studies may inevitably have a broad scope whereas a successful CATO will have a more specific interest. Important in setting any monetary value on preliminary studies will be ensuring that the historical data has been scoped, collected and reported within recognised reporting protocol and/or GIS / BIM systems.

A mechanism to establish monetary value may be difficult where incumbent SO /TOs are competing for contracts with CATOs.

This is an area where the enhanced SO role needs to demonstrate leadership in identifying and recommending from the outset what level of preliminary works is required, as preliminary works for each project needs to be assessed on a case-by-case basis.

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<sup>18</sup> Scottish Planning Policy June 2014 - <http://www.gov.scot/Publications/2014/06/5823>

<sup>19</sup> Collateral warranties are often used in construction or engineering projects where a professional consultant (e.g. engineer) warrants to a third party (such as a funder) that it has complied with its professional appointment, building contract or sub-contract. A clause specifying how many times the benefit of the warranty may be assigned (for example, to a future purchaser) is typically included.

## CHAPTER 3: HOW WILL THE TENDER WORK AND WHAT WILL CATOS GET?

**Question 1: What are your views on our proposed late CATO build tender model? Do you have any views on the basis of bids, use of cost-sharing factors or what risks, if any, it would not be efficient for a CATO to manage during construction?**

Under the late CATO build the consultation indicates the successful bidder will be responsible for procurement, finance, construction, operation and maintenance of the transmission assets. Preliminary works would be completed by the TO or SO and transferred to the CATO at the end of the tender. For any RIIO-T1 SWW projects, the late CATO model would apply where any incumbent TO has already taken forward pre-construction.

### Planning and consenting

The consultation document states that under the late CATO model details of route corridors and planning envelopes, including any requirements from the environmental statement, will be part of the tender specification. We assume therefore that the route corridor will have been selected, assessed within the EIA and a consent granted for a specific project proposal.

In relation to Necessary and Voluntary Wayleaves and servitudes there is a requirement for transfer to the CATO of legal land rights. Where an agreement has not been reached through negotiation (typically non-assignable), licence holders have access to compulsory procedure. They may promote a compulsory purchase order under Schedule 3 to the 1989 Act or may apply for a compulsory wayleave (the legislation uses the terms "Necessary Wayleave") under Schedule 4 to the 1989 Act.

In addition, rights of access to land and land use implication of development is a matter of public / stakeholder interest above and beyond land owner interests with landowner and wider stakeholder engagement considered good practice in promoting wayleaves<sup>20</sup>. e.g. land use planning / utilities / public access / construction impacts.

It would be envisaged that the current system of substantially Voluntary Wayleaves and negotiated access would inevitably formalise around a more legalistic process to achieve Necessary Wayleaves and formal servitude agreements under Schedule 3 or 4 of the 1989 Act.

In Scotland, wayleaves are held by a named Licence Holder and do not transfer automatically, as we understand exists within the Development Control Order (DCO) process. It will become necessary within the late CATO model to re-negotiate and agree Necessary Wayleaves including the rights of assignation over future landowners and occupiers.

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<sup>20</sup> Necessary Wayleaves guidance for applicants, landowners and occupiers. April 2014

Where projects are already in progress and Voluntary / Necessary Wayleaves have been agreed these will need to be reviewed and Necessary Wayleaves would need to be applied for again. The need to renegotiate both Voluntary and Necessary Wayleaves can be anticipated to add additional complexity and will need stronger programming and enhanced resources if this is to avoid adverse programme impacts and delay.

Where all Necessary Wayleaves have not been agreed, Scottish Ministers may or may not make a determination of an application under Section 37 of the Electricity Act 1989 for an overhead line. However Schedule 8, paragraph 6 (2) of the act states that Ministers must have regard to the extent to which the Necessary Wayleaves have been agreed and take into account any prejudicial effect any decision on the application may have on any subsequent proceedings relating to the outstanding wayleaves.

**Question 2: What are your views on our proposed early CATO build tender model? Do you have any views on what tender specification would best facilitate innovative but deliverable bids, and how we can best manage cost uncertainty after the tender?**

Under the early CATO build, the consultation states the CATO will be responsible for the design of the transmission assets and all preliminary works required in order to gain the necessary consents and procurement, financing, construction and on-going operation and maintenance of the assets.

**Innovation – operational expenditure**

Innovative approaches to reduce operational expenditure (opex) of transmission assets is one of the key benefits of competition identified in the consultation. The Scottish Government does not believe that this particular benefit has been fully substantiated within the evidence provided, nor any detail given on how this is expected to be achieved. Further, in a correspondence with the Scottish Government, 17<sup>th</sup> December 2015, Ofgem has outlined that one of the reasons that ‘new, separable and high value’ works are good candidates for competition is due to the “*relatively low opex*”. Therefore, it seems that the potential benefits of lowered opex are marginal.

We do not believe that the lowest opex cost (for only a proportion of the lifespan of tendered assets) should be the overall objective – the assessment should instead be focused on ‘appropriate costs’.

The nature of innovation dictates that its benefits cannot be understood with precision ahead of time and therefore ascribing value is difficult. Nevertheless, we want to understand better the kind of innovations that have been introduced by OFTOs and that could be paralleled by CATOs. We are unclear from the consultation how the introduction of competition will more effectively drive innovation compared with current mechanisms for incentivising innovation at transmission level.

We believe there is risk that technical ‘innovation’ introduced through CATOs may come at the expense of network performance, maintenance and security of supply.

Appropriate and diligent O&M is very important to overall network performance and security of supply. We do not consider that the early availability demonstrated by OFTOs is at this stage a reliable guide for the long term efficacy of the OFTO O&M regimen, due to the relative newness of the asset population.

### Innovation – system design

At present, transmission owners perform high level design in line with the SQSS<sup>21</sup> but most design decisions are based on established design practices specific to each transmission owner. For example, design criteria used when constructing a new substation are guided by the SQSS but the *extensibility* of the substation (i.e. whether or not to prioritise space for future connections) is in practice largely determined by the transmission owner's own internal design policies.

The variety in current industry standards and practices does not provide the ideal template of consistency to set minimum design standards for new transmission owners.

Drawing on experiences from the offshore transmission regime, our stakeholders have pointed out that offshore transmission design innovation has been dominated by narrow and short-term cost considerations to the detriment of wider transmission system objectives and the long-term interests of consumers. An example of this is the inflexibility of offshore transmission designs to accommodate other connections or further transmission works as the works have been designed with the sole intention of connecting the relevant offshore generation.

### Tender process and consenting

Early CATO bidders would undertake only high-level analysis of the environmental impact of their designs and deliverability studies while formulating their tender bids. As proposed, much of the detailed surveys, environmental studies and engagement would take place after appointment. The deliverability of bidders' designs would be evaluated as part of the tender according to the consultation document although the process for this evaluation is unclear.

Under early CATO, tender appointment will be based on high-level information that pre-dates detailed statutory consultation, community engagement, EIA and any clear understanding of delivery risk. Any supposed cost efficiencies identified at this stage would, of course, be highly uncertain and the consultation document floats the idea of introducing some incentives to encourage the CATO to adhere, as far as reasonably possible, to the designs and costs originally bid. This does not appear to be a satisfactory or robust basis on which proceed.

The tender process as outlined would appear to promote a strong 'optimism bias' based on a future capacity to re-negotiate routes, programmes and costs. It could further reasonably be assumed that each bidder will be presenting alternative

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<sup>21</sup> National Electricity Transmission System Security and Quality of Supply Standards (NETS SQSS) establish a coordinated set of criteria and methodologies that Transmission Licensees use in the planning and operation of the National Electricity Transmission System.

schemes with varying levels of stakeholder engagement with subsequent enhanced risks for consents and third party challenges.

**Question 4: Do you have any views on our proposal to prioritise late CATO build? Do you have any views on specific circumstances where early CATO build might lead to better outcomes than late CATO build?**

The late CATO build may produce greater certainty to the bidder on what has to be delivered, given that the requirements of the project have been defined by the consent granted. Any consent granted would need to be conditioned appropriately to ensure that compliance with those conditions can be adhered to. In order to discharge such conditions (which may include pre-commencement conditions) further consultation with statutory stakeholders and others may be required. This may incur delay and increased costs to the public purse through increased administration costs.

We have major concerns with the practicality and suggested benefits of the early CATO model. As set out in our response to Question 2, The Scottish Government does not currently see the early CATO as a viable or desirable option based on its description in the consultation document.

**Question 6: What are your views on our proposed revenue package for CATOs? Do you have any views on the proposed duration of the revenue term, including how it links to the asset cost recovery period, and whether operations and maintenance costs can be fixed over this period? Do you have any views on our proposed approach to indexation, refinancing and enabling new asset investment?**

The consultation does not present sufficient evidence to support the proposed 25-year revenue period. The consultation notes that the proposed term is best suited for access to finance but there does not appear to be any consideration of the potential impact of this on the operation of the transmission system. The Scottish Government considers that it would be more appropriate to link the term of the revenue stream to the expected asset lifetime to ensure, for example, that the CATO is incentivised to extract the full value of the asset. Alternatively, a revenue period aligned with existing transmission owners would not be unreasonable. This would help to minimise risk to consumers and any mismatch between the incentives across all onshore transmission owners.

**Question 7: What are your views on our proposed package of financial incentives for CATOs? Do you have any views on how we could structure an availability-based incentive to ensure CATOs operate their assets with a ‘whole network’ view? Do you have any views on whether there are circumstances under which ‘payment on completion’ would not be appropriate to incentivise timely asset delivery?**

Ofgem propose an ‘energy not supplied’ and ‘availability-based incentive’ for operational performance (asset availability and reliability). The former would see CATOs penalised for any energy not supplied to customers as the result of outages on their assets above an annual threshold. The latter would involve a simple annual availability target with incentive and penalties for over- or underperformance. Ofgem consider that the availability-based mechanism may be the most appropriate incentive mechanism.

Ofgem have also considered three options for incentivising timely delivery. They propose that payment of the revenue stream on completion of construction will be the most effective.

#### Security of supply and fragmentation

The Scottish Government has significant reservations about the proposed financial incentives for CATOs, and considers that they may present a threat to system security, reliability, coordination and deliverability. We consider that simply incentivising availability will not result in a system that has sufficient flexibility to ensure efficient operation and development, as the parties required to coordinate outages (system operator and transmission owners) will be more numerous and have divergent commercial drivers as a result of the regulatory misalignment.

We consider that there are significant risks associated with regulatory fragmentation – having parts of the onshore, integrated transmission system owned by companies that are exposed to different regulatory mechanisms that might distort the overall picture and reduce the efficacy (or increase the difficulty in implementing) of future changes to industry regulations. The design of the incentives for CATOs must therefore be considered carefully to ensure that the behaviours exhibited by CATOs do not make system design and operation more difficult.

We note the proposed approach to linking incentives to the ‘criticality’ of assets, and support the principle as reasonable.

#### Financial innovation

The Scottish Government understands that the potential financial innovation is available by the introduction of new market entrants. However, we are concerned that the market offering developed by Ofgem in order to attract investment may decrease system security by limiting operational risk to CATOs, potentially resulting in a net dis-benefit to consumers. The increased operational risk passed to the consumer is discussed above.

**Question 8: Are there other types of incentives not covered in this chapter that you think should apply to CATOs?**

Standards and protocols

Securing a long term and sustainable electricity transmission network should include incentives to SO/TO/CATOs that are non-financial and support confidence and quality of performance within the network and in the delivery of new infrastructure.

Non-financial incentives should relate to performance around quality and standards and require a monitoring and audit framework operated independently and transparently.

## CHAPTER 4: MANAGING CONFLICTS OF INTEREST

**Question 1: Are there any risks or conflicts of interest arising from the system operator's role that we haven't identified?**

### Management Framework

The Ofgem consultation refers to conflicts of interest but does not state what these might be and these may be far from transparent in a system where SO/TO and CATO have multiple roles. There appears to be a lack of transparency between regulatory functions and commercial functions with implications for planning and consenting and third party challenges including resolution of tender challenges to incumbent SO/TO/CATOs.

Public trust and transparency in the consenting process requires a clear role and responsibility for independent over-seeing of the process where the SO has become a CATO. The consultation document highlights the potential for conflict of interest and invites comment without detailing the key areas of risks in roles and responsibilities. Will Ofgem itself manage and monitor this process and what resources, audit process and detailed engagement would Ofgem propose?

We believe many of the potential benefits of additional competition, innovation and exploration of alternatives will only be secured if a robust management framework is developed. It would be useful if Ofgem could detail in a tabulated framework the scope of conflicts of interest and the mechanisms to mitigate them.

**Question 4: What measures do you think would be appropriate to mitigate the risks and conflicts of interest? What additional conflict mitigation measures would be needed if the system operator takes on a broader role in supporting competition?**

### Independent Framework

In our view an Independent SO should be considered to deliver transparency and auditable quality to a streamlined competitive tendering process. The ISO could, in consultation with SO/TO/CATOs develop the 10-year plan, define NOA, define standards procedures and protocols, establish and manage the tender process and monitoring and audit delivery.

The early CATO and late CATO models will introduce players with new and different interests. These may be quite different from traditional SO /TOs and have more singular focus on, for example: asset ownership rather than operational interest of a network or alternatively construction cost management. The SO role, where more diverse participants are active, becomes more important in ensuring network interests and future connections/adaptation, resilience and standards are appropriately managed and are effective.