

Angelita Bradney
Senior Manager – Electricity
Transmission Policy
Ofgem
9 Millbank
London
SW1P3GE

Your ref
179/11
Our Ref

Date
17 February 2012

Contact / Extension
Alan Kelly
0141 614 1736

Dear Angelita,

Ofgem Consultation: Implementing Competition in onshore electricity transmission

SP Transmission Ltd welcomes the opportunity to comment on the issues discussed in the above paper, and would like to thank Ofgem for accepting our delayed response.

In general terms we do not believe that the anticipated benefits for consumers from the proposals have been sufficiently demonstrated with sufficient certainty. We believe that the probability of third party delivery and ownership providing benefits for customers would be much greater if the third parties were also responsible for the entire project including pre engineering works.

Our experience is that technical design, land rights, planning consents, environmental consents, and tender processes are parallel interactive and iterative processes that ultimately combine to lead to the most efficient and deliverable project specification. To separate these activities will remove a significant opportunity for innovation, could result in longer delivery timescales with the related social cost of delayed energy decarbonisation, and ultimately may simply achieve the false economy of a third party investor prepared to accept a lower return in exchange for lower risks but on an asset with higher capital costs.

We also believe that the proposal to include land rights, planning and environmental consents within the Pre Engineering works fails to recognise a number of practical issues surrounding obtaining such rights for an unknown third party. It is possible that this may result in greater use of Compulsory Purchase powers and the transfer of the rights and consents to the unknown licensee to be subject to a subsequent Statutory Transfer. We do not believe that this would be an efficient outcome.

Further, the current preferred solution will introduce additional commercial interfaces around Pre Engineering works that are likely to result in higher overall cost than would otherwise result from the incumbent Transmission Owners (TOs) internalizing this risk on behalf of customers.

Both these further costs would be avoided by the more optimal solution of the same party being responsible for pre-engineering, delivery and ownership.

We believe greater clarity is necessary from Ofgem in relation to their proposed efficiency test to determine which projects will be selected for this process, and how this might be expected to operate for interconnector projects involving multiple TOs.

New Alderston House, Dove Wynd, Strathclyde Business Park, Bellshill, ML4 3FF

Telephone: 0141 614 0008

www.scottishpower.com

The appendix attached provides a response to each of the questions raised in the consultation document, but we also consider some of the key points in more detail below.

Planning, Consenting and Land Rights Complications arising from unknown ownership

We believe that there is a significant issue in relation to the securing land rights, planning and consenting permissions by the incumbent TO with the possibility of a third party becoming the asset owner.

Section 37 planning consents for transmission assets require the applicant to hold a transmission licence, and in the absence of a known third party licensee these would necessarily need to be obtained on behalf of the incumbent.

Environmental consenting is typically dependent on ownership being clearly defined. It is possible this would lead to significant duplication of work should ownership change.

Land rights are the most complex issue and potentially have the most risk. For the large scale projects envisaged for third party ownership multiple land rights would be required. Various instruments exist to secure assets on property from servitudes to wayleaves to lease to ownership. In the event of change of ownership being likely, lease agreements present the most stable instrument however can be more difficult to secure. It would seem that a move to greater use of Compulsory Purchase Orders would be likely.

Network Technical specifications typically need to be extremely detailed to complete these processes, including for example detailed locations and design of towers including foundations, and very detailed information such as overhead line conductor specifications including material and dimensions.

Transfer of consents between licence holders is likely to be problematic, time-consuming to allow due diligence, and may require to be subject to a Statutory Transfer.

We believe these issues represent a serious obstacle to the incumbent TO seeking and obtaining consents and land rights on behalf of an unknown third party.

Potential Risk to Cost and Timescales

Scope for innovation will be reduced. Typically land rights, planning and consenting are dependent on having a firm design. However, an iterative cycle does typically operate which can extend into and beyond the tender stage and appointment of suppliers. This allows innovative design and other technical solutions or trade-offs to be identified and corresponding changes to planning agreements, design, circuit routes, and network footprints to be accommodated. To ring fence stages of the process, even if defined handovers can be established, will inevitably lead to longer project life-cycles and we would expect to loss of efficiencies.

Tenders from specialist contractors to a new TO are unlikely to result in lower project costs. Our RIIO-T1 submission emphasised the challenges of deliverability and lays out our strategy to eliminate the inefficiencies of turn-key project delivery model. This strategy was well received by Ofgem as it reduces overall costs by mitigating risk factors such as duplication of layers of liability through the supply chain. Our procurement strategy also encourages competition through the tender process with a number of expert suppliers. The inevitable consequence of the

third party model illustrated in Figure 4 of the consultation would be multiple tenders with the same expert suppliers responding to each of the potential third party contenders for the same tightly specified design, with little if any scope for innovation. Ultimately this may simply achieve the false economy of a third party investor prepared to accept a lower return in exchange for lower risks, but on an asset with higher capital costs.

Processes may become increasingly onerous and costly for connecting parties. Whilst the changes to the codified processes involved in fulfilling TO obligations may be relatively simple to extend to new TOs, the practical application of those processes themselves may become increasingly onerous to fulfill with increasing numbers of TOs.

For example the 'affected TO' process requires any transmission or large distribution connection to be notified to all TOs to assess if their network is affected. Connecting parties pay National Grid to enable each of the TOs to perform impact assessments. In the event of multiple TOs joining the market, this will inevitably add cost and delay to both transmission and distribution projects. Other obligations may well have a similar effect.

Conclusion:

We believe that there is a clear argument that the most efficient solution for delivery of projects of this type is for one party to be responsible for pre engineering works, delivery and ownership.

Greater clarity is required from Ofgem around key aspects of the proposals, specifically in relation to their proposed efficiency test to determine which projects will be selected for this process, and how this might be expected to operate for interconnector projects involving multiple TO.

However, we believe that the preferred solution set out in the consultation:

- a) Reduces scope for innovation, potentially resulting in increased costs;
- b) Introduces unnecessary commercial interfaces that will result in increased costs;
- c) Faces a significant challenge to developing a practical solution to incumbent TO's obtaining land rights that are ultimately for a third party;
- d) Is likely to increase overall delivery timescales with a direct impact on delivery of carbon targets.

If you have any queries regarding any aspect of our response, or would like to discuss these matters in more detail, please do not hesitate to contact myself or Alan Kelly.

Yours sincerely,



Jim McOmish
Policy Manager (Transmission & Distribution)

Appendix 1: Response to specific questions raised in the consultation.

These answers should be read in conjunction with points raised in our covering letter

CHAPTER THREE

Q1: Do stakeholders consider that we have correctly identified the changes to industry codes that would be required to enable third party involvement in onshore electricity transmission?

We consider the relevant aspects of the codes have been considered, however we have significant concerns that the practical application of TO obligations when multiple TO's enter the market will have consequential negative impact on project costs and timescales. Further, we believe the proposals for timing of licensing new Transmission Owners, we believe, will present significant practical and legal hurdles in relation to land rights, and planning and environmental consenting.

Q2: Do stakeholders have any comments on the changes proposed to the industry codes in Appendix 2?

See Answer to question 1.

Q3: Do stakeholders have further comments on the proposed process and timetable for enabling the industry code modifications?

The timetable may be challenging as further comprehensive stakeholder consultation will be necessary on any detailed proposals.

CHAPTER FOUR

Q1: What level of detail would be required for the following pre-construction outputs in order to hold an effective selection process:

We believe the selection process should start at an early a stage as possible. There are a number of concerns we have outlined in the body of our response to conducting pre-construction activities in advance of the selection process.

We recommend minimal design and specifications should be included as the basis for the bid information, to allow the maximum opportunity for a single party to co-ordinate all stages of the project. This will potentially maximise efficiency savings from innovation, enabling design changes and removing the issue of ownership from undermining planning, consenting and land rights processes.

By adopting this model there would be a greater likelihood that the outcome will be an overall more efficient solution than separating the pre engineering activities identified by Ofgem from the project delivery.

Our experience is that technical design, land rights, planning consents, environmental consents, and tender processes are parallel interactive and iterative processes that ultimately combine to lead to the most efficient and deliverable project specification. To separate these activities will remove a significant opportunity for innovation, could result in longer delivery timescales with the

related social cost of delayed energy decarbonisation, and ultimately may simply achieve the false economy of a third party investor prepared to accept a lower return on an asset with higher capital costs.

We also believe that the proposal to include land rights, planning and environmental consents within the Pre Engineering works fails to recognise a number of practical issues surrounding obtaining such rights for an unknown third party. It is possible that this may result in incumbents needing to use Compulsory Purchase powers, and the transfer of the rights and consents to the unknown licensee to be subject to a subsequent Statutory Transfer. We do not believe that this would be an efficient outcome.

Further, the current preferred solution will introduce additional commercial interfaces around Pre Engineering works that are likely to result in higher overall cost than would otherwise result from the incumbent Transmission Owners (TOs) internalizing this risk on behalf of customers.

Both these further costs would be avoided by the more optimal solution of the same party being responsible for pre-engineering, delivery and ownership.

Q2: Should planning consents be in place before the selection process?

As previously described planning consents require ownership to be stipulated and design to be firm. Packaging these up in advance of selection is likely to minimise opportunities for innovation and design optimisation and increase both timescales and cost through additional due diligence and transfer of rights.

It is also possible that the adoption of a solution where the incumbent TO secures rights for an unknown third party may necessitate a greater use of Compulsory Purchase Powers which is likely to increase costs and timescales.

Q3: Should land be purchased or wayleaves obtained by the incumbent TO before the selection process?

We do not believe this is the most appropriate or efficient solution, as per answer 1 and 2.

Q4: What are stakeholders' views on the desirability of Ofgem seeking independent verification of the needs case and solution proposed by the incumbent TO in advance of any selection process?

All transmission investment projects are subject to challenge and scrutiny by the GB System Operator and by Ofgem at various points throughout their life cycle. If Ofgem had any concerns over value for money or efficiency of a project, we would expect this to be raised with the TO in the first instance. We are concerned that the criteria for verification are undefined, and clear rules need to be established. The possibility of this activity being included after pre—construction stage will inevitably lead to longer project delivery timescales and should be avoided

Question 5: Do stakeholders have a view on whether pre-construction outputs could be retained by the incumbent TO or transferred to the eventual asset owner? Is there a difference depending on the output in question?

We have stated already that land rights, planning and other consents are dependent on ownership there for must be secured or transferred to the owner if there is a successful third party bid, the incumbent TO should not need to retain other pre-construction outputs, except as required for the interface with the new network.

Question 6: What kind of commercial arrangement, if any, should be used to facilitate the sharing or transfer of pre-construction outputs between an incumbent and third party TOs?

We do not favour the selection process being after pre-construction, in part because due diligence would be required to assess the arrangements included, and this potentially introduces the additional cost of design warranties and guarantees.

Arrangements would need to take account of the incentive regime for wider works proposed for RIIO T1. We would expect that any penalties for late delivery would apply on a comparable basis to third party licensees.

Question 7: Do stakeholders consider that the staged approach we have outlined, which would allow interested parties obtain a 'light touch' licence, is appropriate?

We consider this option could be effective. Although it is important that all relevant licence requirements apply in full to the third party TO in order to avoid distortion of the selection process.

Question 8: Do stakeholders agree that some form of business separation arrangements will be necessary for incumbent TOs?

The incumbent TO will retain responsibility for the project if the selection process does not result in a third party being selected. It is not clear therefore, that additional business separation measures are necessary or appropriate in the event of the incumbent TO bidding for the project.

We consider the implications may be unworkable in practical terms as we would have to ring fence key staff and systems to develop bids for third party projects as and when they become available.

However, business separation concerns are greatly reduced if the selected TO is responsible for all aspects of delivery, which we believe will deliver an overall more efficient solution.

Question 9: What form of business separation arrangements do stakeholders feel would be appropriate for incumbent TOs?

Please see our response to question 8.