RIIO-T1 Implementing competition in onshore electricity transmission – SSE Response

This response is made on behalf of SSE plc, who are the second largest generator in the UK, with over 11.5GW of generation capacity, 2GW of which is renewable. We are the UK's second largest energy supplier, with around 10 million customer accounts for gas, electricity and other home services, and we have an electricity networks business which is responsible for the delivery of power to around 3.5 million homes via 128,000km of overhead lines and underground cables.

Summary

We do not support the proposal to implement competition in onshore electricity transmission because:

1. The benefits of such a proposal have not been demonstrated and we are concerned about the risk of delay;
2. Alternative options have not been considered, e.g. implementing competition in generator connections;
3. The consultation is not comprehensive. In particular, it does not address key issues of competency e.g. is primary legislation required (as was required to facilitate the transfer of assets in the OFTO regime), how are the connection obligations detailed in the existing PSO impacted, what is the interaction with the planning and wayleave process; and
4. The proposal appears to underestimate the scale of work required and the time this will take. The development of the OFTO regime took in excess of 10 years and is still not yet fully mature. Substantive reform, as is proposed in this consultation, is very unlikely to be achieved in 13 months.

We believe that the implementation of this proposal will result in uncertainty in areas where there has already been a huge amount of work done to address uncertainty, e.g. Transmission Access Review, RIIO and ENSG.

Our response to the current consultation is attached and set out in three sections –

1. An overview of our concerns relating to the implementation of this proposal
2. Detailed considerations on the process being proposed
3. Specific responses to the questions set out in the consultation document

1. Key Issues

Understanding the impacts of the introduction of competition

The proposal to introduce competition to onshore electricity transmission is a significant change to the existing GB regulatory arrangements. The impact of this change should not be underestimated, particularly when it is proposed to commence at a time when substantial levels of investment in the transmission network are required, against a backdrop of the currently challenging economic environment. Any change to existing arrangements has the potential to introduce investor uncertainty but a proposal of this magnitude, developed at this particular time, is very likely to destabilise the investment environment that the industry has worked so hard to secure and hence potentially delay the development of the GB transmission network. Should such a delay occur, there are likely to be consequential impacts for many parties within the value chain, not least GB's ability to meet its 2020 targets.

This is not merely a subjective assessment of the impact of such large scale change. There are real and comparable examples where such substantive reform has taken much longer than expected including the Code Governance Review, implementation of competition in electricity distribution connections and, most notably, the development of the OFTO regime. There is also real evidence of such substantive reform driving investor uncertainty, which is particularly apparent in a number of consultation responses regarding the OFTO regime and also in relation to the work ongoing on Project Transmit. This consultation document does not address how these risks are to be identified and impacts are to be avoided or mitigated.

The most relevant comparator of substantive reform is the OFTO regime which took more than 10 years to develop and has not yet reached a level of maturity where participant concerns have been fully addressed. Ofgem's current proposal to implement competition in onshore electricity transmission may well be more complex to implement than the OFTO regime and yet it is proposed that implementation will be completed in little over 13 months from now. Based on the OFTO comparator, this does not appear a credible timetable and hence already brings uncertainty into the change process. Such uncertainty would be reduced through a detailed, realistic timetable backed up by a resource commitment from Ofgem and the industry. Where the implementation of competition in offshore transmission impacts only a single customer, the effects of competition in onshore transmission will impact many, including domestic customers. Furthermore, the outcome of the OFTO tender process is effectively decided by that single customer whereas the outcome of the onshore tender process is to be decided by Ofgem on behalf of the many impacted customers. This is certainly likely to be a more complex and potentially riskier decision to make on behalf of customers and we do not see how this is likely to speed up the delivery of transmission infrastructure.

Such substantive reform has the potential to undermine the significant amount of work that has already been done to address investor concerns around grid uncertainty, in

particular calling into question the outcome of the Transmission Access Review, the ENSG, Project Transmit and planning reforms.

In light of the potential risks introduced by this change, we would expect that any potential rewards would be demonstrably worth such risk. We would also expect that –

- The issues, which are to be addressed by the introduction of competition, would be widely recognised and accepted;
- An Impact Assessment, which considers a range of options for resolving these issues, would be complete; and
- Clear, quantifiable benefits of the chosen solution would be available.

To date, in our view, none of the above points have been addressed. There appears to be a lack of evidence to support the substantive reform that Ofgem are proposing to take.

The benefits that will be realised the introduction of competition

There does not appear to be any evidence of issues relating to transmission investment which are expected to be resolved through the introduction of competition. Not a single respondent to the March 2011 consultation suggested that there were any specific issues that a competitive approach to the delivery of onshore transmission would be likely to resolve. On the contrary, there were concerns raised by most respondents about whether competition would, in fact, delay the timely delivery of transmission infrastructure. There appears to be a strong case which suggests that any issues relating to transmission investment have already been addressed.

1. The 2007/8 Transmission Access Review was to deal with the "queue of electricity generators that have been unable to gain access to the transmission system for a number of years." The review recognised that existing access arrangements did not facilitate the quick connection of generation, particularly renewable generation, to the network. As a result of this review, several measures were successfully implemented –
    - Interim Connect and Manage access arrangements, allowing generators to connect ahead of wider reinforcement works;
    - The creation of the Electricity Networks Strategy Group, jointly chaired by Ofgem and DECC and supporting the development of credible network scenarios;
    - The implementation of Transmission Investment Incentives (TII) mechanism to encourage network investment; and
    - The ex-ante allowance of pre-construction funding to allow timely development of transmission infrastructure projects.

    These measures have been successful in allowing quicker access for generators and encouraging investment. Over and above the £4bn allowed in TPCR4, an additional £300m+ was allowed by Ofgem for network investment (through TII

funding) between April 09 and January 10 alone. In accepting SHETL and SPTL for fast-tracking through RIIO-T1, Ofgem stated that, "the revised price control packages put forward by SPTL and SHETL constitute well-justified business plans which demonstrate a clear consideration of the views of their stakeholders and provide good value for money to both existing and future consumers." Ofgem note that both companies have, "strong incentives to deliver those outputs and face penalties for failure to deliver." There has been no suggestion that measures implemented to resolve the TAR issues have failed but rather, on the contrary, Ofgem are confident that the future investment plans of the TOs are fit for purpose, providing good value for money for existing and future consumers.

The Transmission Access Review resulted in a licence obligation on TOs to meet generators reasonable expectations in respect of connection. The Public Service Obligation gives certainty to new connections.

2. During the development of RIIO-T1, and building on the work of the ENSG, the TOs have responded to the need to invest in the transmission network through their Business Plans. National Grid has demonstrated a plan to invest up to £30bn in the England and Wales transmission network. The Scottish TOs plan to deliver a baseline £2.9bn of investment with an additional £4.7bn forecast throughout the price control period. In light of the plans presented by the Scottish TOs, Ofgem has, in January 2012, decided to "fast-track" both TOs, stating that, "Both companies have embraced the new RIIO process and understood its importance in addressing the question of how best to meet future energy demands at the lowest cost to consumers. Their business plans provide good evidence of how the companies will deliver significant benefits to consumers through greater efficiency, enhanced consumer engagement and investment. The fast-tracked companies can now benefit from the swiftness of the process and concentrate on delivery efficient network improvements for consumers."

   It should be noted that in making a positive assessment of these business plans, Ofgem, as set out in the October 2011 "Initial assessment of RIIO-T1 business plans", sought evidence which demonstrated that the plans would deliver, "outputs at value for money over the longer term." In particular, Ofgem tested whether the plans provided evidence of –

   - "the processes and tools they used to determine their efficiency
   - external benchmarking evidence such as comparisons with other industries or across the same industry domestically and internationally, and the actions arising from this evidence
   - evidence of market testing, for example through tendering
   - a clear demonstration that the longer-term had been considered in developing the plan."

The decision to fast-track both Scottish TOs proves that the business plans submitted meet Ofgem's requirements pertaining to efficiency and value for money.

There is no indication that Ofgem have any concerns over the timeliness, efficiency or cost of delivery of transmission infrastructure. On the contrary, through the decision to fast-track both Scottish TOs, Ofgem confirm that they are satisfied with the companies' investment plans for the future. Additionally, the recent update on their assessment of the Western HVDC project confirmed that Ofgem consider that "a competitive tender, run via an efficient procurement process, will have resulted in an efficient outcome." As this is the basis on which all onshore transmission infrastructure is delivered, if does not appear that there are any issues to be resolved by further competition in this area.

3. Previous proposals to introduce competition in transmission delivery, particularly for the construction of a Western Isles link, have met with little support. As a result, Ofgem concluded, in 2008, that "the need to implement changes to support a competitive approach for Scottish islands connections represents a significant risk to the timely completion of the proposed connections to the Western Isles and Shetland." We do not believe that there is evidence to suggest that this conclusion is no longer correct.

   Significant efforts have been made over the past five years by the Government, Ofgem, transmission licensees, customers and wider stakeholders to ensure the timely delivery of grid infrastructure. A key conclusion has been to put in place a stable environment for the large investment requirements. We believe that these reforms have been effective and are not aware of customers' requiring further reform (notwithstanding continuing work on access and charging and development of the OFTO regime).

An Impact Assessment which considers a range of options

Without clarity on the issues which are expected to be resolved, we acknowledge that it may be difficult to complete an accurate Impact Assessment. However, there does not appear to be any available Impact Assessment.

We have engaged with Ofgem a number of times, during 2011, on the proposal to implement competition in onshore electricity transmission as we believe that, if facilitating timely generator connections are a key driver for introducing competition, there are real benefits to be gained by implementing competition in the delivery of sole-use infrastructure. This has been demonstrated in Electricity Distribution and is similar to the outcome delivered by the OFTO regime. In both instances, the user decides the outcome of the competitive process as it is the user who, ultimately, directly benefits. We believe that this could be implemented relatively easily, given the precedent in Distribution and OFTO. Lessons could also be learnt from those experiences.

In light of this previous engagement, we expected that such an Impact Assessment would be required prior to any policy decision being made. This Impact Assessment would be expected to take into account the results of a "do nothing" approach versus alternative approaches to the implementation of competition (say, in sole-use infrastructure for generator connection as has described above), set against the likely impact of the current proposal. However, it appears as if a policy decision has been made without due consideration of the alternative options. This is very disappointing.

Ofgem have an obligation, under the Utilities Act 2000, to complete an Impact Assessment if a proposal could be considered to, amongst other things –

- Involve a major change in the activities carried out by the Authority; or
- Have a significant impact on market participants in the gas or electricity sectors; or
- Have a significant impact upon persons engaged in commercial activities connected to the gas or electricity sectors.

It is very clear that even the principle of introducing competition into onshore electricity transmission, not to mention the detailed process, could be considered to meet these three criteria. Failure to follow due process may expose Ofgem to challenge, with the potential to introduce further delays and increase uncertainty. We strongly urge Ofgem to complete this Impact Assessment prior to further progression of this proposal. We would be concerned if detailed development was to precede and Impact Assessment, as this would prejudice the outcome of that Impact Assessment.

Clear, quantifiable benefits of the chosen solution

If a policy decision has been made to progress this solution regardless of possible alternatives, then it would be expected that the benefits of such a solution must be very clear and quantifiable. However, even in the most recent consultation, Ofgem accept that, "We cannot predict at this stage what the benefits would be…".

We do not believe that the likely risks associated with this proposal are outweighed by benefits which cannot yet be predicted. This particularly highlights the need for an Impact Assessment prior to progression into detailed development.

The timescales proposed for implementation

The scale of this change is similar to that faced in the implementation of the OFTO regime. The OFTO regime was the subject of an extensive and lengthy consultation process which started in 2002. The broad timeline of events was –

2002	DTI consultation on Strategic Planning Framework for Offshore Generation
2005	First joint Ofgem/DTI consultation on the design of the OFTO regime
2006	First Scoping consultation resulting in 5 work streams/groups
2008	Final policy decision on design of OFTO regime

2009 Planned Go Live

2010 Actual implementation of Tender Regulations

2011 Further consultation on the design of the Enduring Regime

A significant number of consultations, open letters and workshops on the OFTO regime were progressed during the 10 years of development but still offshore developers have concerns and uncertainty about the deliverability of the OFTO regime. This has lead to the drive for a "generator self-build" option which may provide the developer with greater certainty over delivery but was not fully envisaged at the outset of the development of competition.

The proposed timetable for the full implementation of competition in onshore electricity transmission is around 2 years. The first consultation in March 2011 set out Ofgem's "Early Thinking" on the implementation of competition in onshore electricity transmission. The next, and current, consultation was published in December 2011 with an apparent policy decision but little more firm detail. The project now has around 13 months to implement a change which lasted more than 10 years in the development of the OFTO regime. Furthermore, this timetable does not take into account the length of time required to complete a Significant Code Review (estimated to be around 12 months) and the timescales required to complete further consultations (8 – 12 weeks per consultation). In light of these considerations, the timetable for the implementation of competition in onshore electricity transmission does not seem reasonable.

In addition to consideration of the necessary Significant Code Review, consideration must also be given to the other components of industry governance that will be impacted by the introduction of competition. Such governance includes, but is not limited to, licences (both current and those being drafted for the implementation of GD1 and T1 Price Controls), connection agreements, connection obligations and Statutory Instruments (include Guaranteed Standards).

As such, we recommend that Ofgem review their proposed timetable and present a well defined and realistic programme of delivery.

2. Detailed considerations relating to the process being proposed

Whilst we have set out, above, our key issues relating to the current proposal for the implementation of competition, we have further concerns that the current proposal does not adequately consider a number of factors. If it is decided that, taking into account the observations above, there is strong evidence to support the introduction of competition in onshore electricity transmission, it is critical that further consideration is given to the details of the current proposal.

In order to assess what further consideration is required, it is important to understand how the wider reinforcement projects, which might be open to competition, are currently funded. This proposal would amend those existing arrangements; hence it is important to be clear where changes are to be made to those arrangements, and how those changes will improve the existing arrangements but also, critically, not disrupt ongoing delivery.

RIIO-T1 arrangements for funding the delivery of wider reinforcement works

During the course of developing the RIIO-T1 Business Plans, the TOs recognised the need for ongoing significant investment in the transmission network, building on the TIRG and TII projects delivered under TPCR4. This investment is required to facilitate new (predominantly renewable) generation, relieve existing system constraints and secure demand.

Although National Grid included their forecast of expected wider works expenditure in their baseline, SHETL, and SPTL to a lesser degree, recognised that, although the need for investment is clear, the timing, scope and cost of each specific reinforcement may not accurately be known at this time. With this in mind, rather than include funding for these significant reinforcements in the baseline allowance at the beginning of the T1 period (and hence expose customers to undue risk), it was proposed to bring each reinforcement forward for funding as more accurate scope and costs become known. This approach ensures that the right reinforcements are being delivered at the right time and that, importantly, consumers only pay for these reinforcements when they have been proved to be economic and efficient.

The flexible funding arrangements for SHETL and SPTL have been set out in the RIIO-T1 Initial Proposals, and are described below. The arrangements for National Grid are still subject to scrutiny.

Strategic Wider Works funding arrangements for SHETL and SPTL

The arrangements for bringing these wider reinforcement projects forward for funding has been developed and agreed through the RIIO process. These arrangements, which are set out in more detail in Annex 1, can be presented as follows –

1. The licensee identifies a need for wider reinforcement works and, following network studies, optioneering, cost-benefit and least-regrets analysis, develops a proposal which it believes represents the most economic and efficient solution for reinforcement of the network.

2. This proposal is set out in a high level Needs Case, which includes information on scope, timing, environmental and security benefits. It will often include supporting documentation from independent consultants who have been asked to scrutinise the reinforcement proposal. At this point, the costs and detailed scope can only be indicative as further refinement is required.

3. The Needs Case is presented to Ofgem for assessment. This process may take around 3 – 6 months and is likely to include the input of independent consultants and views from stakeholders via Ofgem's consultation process. Once satisfied, Ofgem will publish their assessment of the proposed reinforcement.

4. Whilst Ofgem's review of the Needs Case is in progress, the licensee will develop further detail on the proposed reinforcement. This will form the basis of a Technical (Costs & Outputs) submission. This submission includes –

    - Accurate cost forecasts for all components of the project
    - Programme information
    - Procurement and contracting information
    - Detailed design information
    - Consent and planning information

    In order to further develop the proposal to the point of Technical (Costs & Outputs) submission, the licensee will have gone through a process of seeking necessary planning consents, interacting with the supply chain (often to the point of preferred bidder), surveying routes, discussing outage requirements with the System Operator and other detailed pre-construction activities. This ensures that the Technical (Costs & Outputs) submission, which effectively requests the funding required, can be as accurate as possible.

5. This Technical (Costs & Outputs) submission is then presented to Ofgem who will complete a thorough assessment of it. This assessment will focus, fundamentally, on whether the reinforcement is to be delivered economically and efficiently and whether the funding requested represents value for money for the consumer. It is expected to take around 3 – 6 months to complete and will also include engagement of independent consultants and take into account the views of stakeholders.

6. Only once Ofgem are fully satisfied that the project will be delivered economically and efficiently will funding be allowed and the licensee can progress with construction.

It is evident, from the process described above, that these wider reinforcement works will undergo significant investigation, assessment and scrutiny right from the initial proposal, throughout project development and finally at the point of funding request prior to construction. It is important to note that only at the point of submitting the Technical

(Costs & Outputs) submission can the project be said to be “fully formed”. In other words, although the Needs Case sets out a high level project scope and cost, a detailed “value for money” assessment cannot be executed until the refinement is complete and components such as contracting strategy, programme efficiency, consent constraints etc are known.

Ofgem’s proposals cannot be assessed in isolation and must be considered in light of the process described above. With this in mind, we have set out our response to each section of the consultation below.

Likely benefits of competition

1. We welcome Ofgem's statement that the option to introduce competition in the delivery of wider reinforcement works will only be used when it is felt that there are clear benefits to be gained by doing so. We also note that Ofgem have published criteria under which this statement might be tested and projects assessed as eligible for a competitive process. However, we have some observations about the criteria proposed –

- The first test is whether the project is "significant in scale and/or cost". It is important to quantify what "significant" means so that this test can be consistent and transparent.

- The second test is that the project involves assets which are "not meshed with existing assets". Again, this requires definition prior to ensure that the test is consistent across projects and TOs. One of the biggest differences between this proposal and the OFTO regime is the potential impact on domestic customers. An investment in new build assets to connect a large generator is a very different proposition than a replacement project that serves many customers. We strongly believe that this competition should be for new build only.

- The third test is to ensure that allowing competition will not "pose significant risks to timely delivery". There are two areas to consider when testing this –

    o Delay imposed by the competitive tender process

    Given that the project can only be considered to be "fully formed" once the Technical (Costs & Outputs) submission has been presented to Ofgem, we expect that this submission point would be the earliest opportunity for Ofgem to be in a position to make a reasonable assessment of the potential benefits of introducing competition. In most cases, this submission point would be between 6 and 9 months before the TO expects to commence construction (sometimes less if customer/generator requirements dictate). However, taking the OFTO regime as an example, the tender process is likely to be around 18 months which would immediately introduce a 9 month delay to commencement of construction. It is not clear how this delay can be overcome.

    If it is proposed to put a project to the market before it is developed, or midway through development, this raises many other questions. For example, how certain is the project and , if it is uncertain, why would parties bid?

    o Delay because of the transfer of programme between TOs

    Once the competitive tender process has resulted in a third party licensee being appointed to deliver the project, the programme for delivery effectively

transfers to the new licensee which will result in the new licensee having a number of immediate activities to complete including, for example –

Securing consents – e.g. wayleaves, Town & Country Planning consent, Section 36/37 consents and Marine Licence. These consents will usually have been secured by the existing TO as part of the pre-construction process but may not be automatically transferable to a new TO. In particular, wayleaves are an arrangement between landowners and TOs which are often quite specific and the process of renegotiation may be lengthy. Also, Section 37 consent, which is provided by the Scottish Government (in the case of the Scottish TOs), may need to be revisited. This will be particularly important if the new TO proposes a different technical solution than that which was originally pursued by the existing TO, as a full set of new consents would be likely to be required.

Transfer of lease – e.g. site lease, Crown Estate lease etc. These are commercial arrangements between parties which also may not be automatically transferable to the new TO, thereby requiring the new TO to commence their own negotiations.

Supply chain arrangements – although this may have been addressed through the preparation of the competitive bid, it is unlikely that the successful third party will commit themselves to contracts ahead of the project being awarded to them. This may lead to supply chain constraints, particularly in the area of underground and subsea cable manufacturers.

The effect of these activities being transferred to the new TO may not be quantifiable at the point of making a go/no go decision on whether to introduce competition and therefore it may not be possible to satisfy this test adequately. Such transfers must include the transfer of liabilities and obligations, not just the benefits. Experience from the introduction of BETTA suggests that such transfers can be subject to detailed and timely negotiations between parties.

- The fourth test is to ensure that giving third parties a greater role in delivery will not pose "significant risks to the safety, security, integrity and quality of energy services." We do not believe that the use of "significant" is appropriate in this test as surely the introduction of any risk to the safety, security, integrity and quality of energy services would be unacceptable. This should also be quantified to ensure that the test can be consistent across TOs and projects.
- The fifth test is that there is a demonstration of expected potential long-term benefits. This should also be quantified and presumably would form the basis of output measures for the new TO.

It is essential that the criteria are transparent, consistent and effective if they are to be used to instigate a competitive process for wider reinforcement projects.

2. Ofgem consider that there are potential benefits for consumers through reduced network charges through –

- Innovation benefits in the design of the network solution
- Construction benefits: lower delivery costs and more timely delivery of infrastructure
- Finance and operation benefits: lower financing and operating costs

However, we do not believe that there has yet been full consideration of each potential area of benefit. Our initial thoughts on these are as follows -

With regard to innovation benefits –

- As mentioned above, a number of existing mechanisms (IFI and LCNF) already encourage significant innovation in networks and this will continue through the NIA and NIC. As existing mechanisms are deemed to be successful in delivering innovation with recognition at both national and European level, we would welcome further assessment and quantification of what further innovations competition is expected to bring, over and above the existing arrangements.
- As the design of the network solution is developed at a very early stage in the project life cycle, and a long way before the submission of the Technical (Costs & Outputs) information which would allow Ofgem to make an informed value for money assessment, it is difficult to see how a third party licensee could input to that design solution post-award. This would require detailed and extensive knowledge of the TO's network and the interactions between parts of the system which would certainly be considered to be confidential information. Furthermore, if a revised design solution were to be developed post-award, the TO would need to be allowed time to assess that proposed design and its compatibility with the wider network, which may, in turn, delay delivery of the reinforcement. We are not convinced that this is either efficient or has the potential to deliver benefits for consumers. Alternatively, if the competitive process was to commence at the outset of the recognition of need, innovation would need to be presumed, as a detailed design can only be established after lengthy preconstruction, including engagement with the supply chain.

With regard to construction benefits –

- The majority of the delivery costs associated with wider reinforcement projects are made up of items and services which are procured efficiently through a competitive tender process under EU law. In their recent update on the progress of the Western HVDC project, Ofgem stated that, in respect of their value for money assessment of the

project, they are working on the assumption that "a competitive tender, run via an efficient procurement process, will have resulted in an efficient outcome," and that they "do not anticipate the need to conduct a detailed assessment of efficient costs of items included in the contract price." We expect that both existing TOs and new third party TOs will continue to be required to efficiently procure items and services through competitive tender process and therefore the outcome of these will be deemed to be efficient. As such, we would welcome further detail on how Ofgem expect the competitive tender process of a third party TO to deliver greater benefits than the same competitive tender process carried out by existing TOs.

- The appropriate delivery date for a wider reinforcement project is set out in the Needs Case. This optimum date takes into account factors including generation connection requirements and system constraints – again, this is well illustrated by Ofgem's work on the Western HVDC project. The project is then programmed to deliver to this date. The proposal that third parties might offer "more timely delivery of infrastructure" suggests that they might be able to deliver project earlier than the optimum date set out in the Needs Case. However, if the reinforcement is not required earlier than the optimum date, this has the effect of imposing costs on consumers before benefits are realised. We do not believe that earlier is always a more beneficial outcome for consumers.

With regard to finance and operational benefits –

- It may be the case that third party TOs, who would potentially have much less stringent licence obligations relating to financeability than existing TOs, can access cheaper financing. To compare the financing arrangements of an existing TO and a third party TO (with "lite licence obligations") would not be a like for like comparison. In this respect, the proposal to allow existing TOs to create a ring-fenced entity and compete on a level-playing field would allow all competitors to access cheaper financing arrangements. That said, the financeability obligations exist for a reason – to protect consumers. If the third party TO has "lite licence obligations" in this area, how can Ofgem be assured that consumers will have the same level of protection as they currently do?
- Without evidence, it is difficult to assess whether a third party TO would bring lower operating costs to a project. It is expected that a stand-alone third party TO would not have the opportunity to seek synergistic benefits from existing operational arrangements, as incumbent TOs would and therefore we suspect that, in fact,

operational costs may be higher. We would, however, welcome further analysis in this area.

3. We note that Ofgem propose, in paragraph 2.6, that third party TOs might be able to deliver infrastructure faster than existing TOs. However, this does not recognise supply chain resource demands which would be common to both third party and existing TOs and would be likely to have the same ultimate effect on the delivery date of wider reinforcement works.

4. Finally, as Ofgem confirm that they "cannot predict at this stage what the benefits would be," we wonder whether, given the certain costs and potential risks of introducing competition to onshore electricity transmission at this time, it is the best course of action to protect the interests of existing and future consumers.

Changes to industry codes

1. We agree that a substantial number of definitional changes will be required to the codes mentioned in the consultation document. As set out previously, it is not just industry codes that will need to be amended but, instead, a much broader range of industry governance arrangements. The breadth of the review required is substantial. However, as the roles and responsibilities of the third party TOs are not yet defined, and it is expected that this will have further, potentially greater impact on the industry codes and governance arrangements, it may be prudent to delay the codes changes until these roles and responsibilities are understood.

2. We understand that the roles and responsibilities of third party TOs will be the subject of a specific consultation shortly. We intend to provide detailed views at that stage and welcome Ofgem's intention to consult.

3. As mentioned above, we have concerns about the scale of work required in the timescales set out. The implementation of competition in onshore electricity transmission is similar to the challenge faced in developing the OFTO regime. The OFTO regime took over 10 years to develop and is not yet fully mature. The proposed timescale of the implementation of competition in onshore electricity transmission is little of 13 months. The implementation of code changes alone are expected to be substantial and should not be rushed in order to meet an unrealistic deadline. Ofgem's own assessment of the timescale for a Significant Code Review process is in excess of 12 months. We urge Ofgem to present a realistic assessment of the timescales proposed for implementation, underpinned by a detailed project plan.

Pre-requisites for an effective selection process

1. We note that the majority of stakeholders responded to the previous (March 2011) consultation in confirmation that incumbent TOs should continue to identify the need for future investment. We agree that this is the most efficient and effective method for indentifying future investments. However, we note that the

transmission licensees' system development is driven by an obligation to provide connections. This obligation would need to be revised if competition was to be introduced, as licensees could no longer make a contractual commitment to deliver necessary infrastructure. Following the Transmission Access Review, this obligation is a PSO under European law and hence we would welcome an understanding of how this is to be lifted. This issue should be progressed as a matter of urgency as a large and growing number of contracts are in place.

2. Existing TOs, through the TPCR4 and RIIO-T1 arrangements, have agreed allowances for pre-construction of wider reinforcement projects. These projects are set out in each TO's Business Plan and, in many cases, pre-construction will have already commenced. Whilst we agree that it is important to avoid duplication, pre-construction must be permitted to continue as programmed otherwise the ultimate delivery date of the wider reinforcement is in jeopardy. Introducing uncertainty into the development of wider reinforcement projects may undermine progress on pre-construction activities and cause delivery delays.

3. Ofgem propose a number of pre-construction outputs which would be available to third parties on an equal basis. We agree that some pre-construction outputs should be made available to third parties and we expect that these would be available post-submission of the Technical (Costs & Outputs) information. However, it is important to recognise that some of this information may be regarded as commercially sensitive to third parties (for example, in the supply chain) and therefore consideration should be given to what information can, in fact, be shared with potential bidders and at what stage information should be made available.

4. Ofgem proposes to seek independent verification of the Needs Case and proposed technical solution. This independent verification is already carried out by Ofgem and would be expected to continue, through the process detailed in Annex 1. However, if the outcome of this independent review was that the need did not exist, clearly there would be no requirement for a competitive tender process as the wider reinforcement should not proceed at that time under either existing or third party TO. Secondly, and given that the scope of the technical solution presented in the Needs Case is reasonably high-level and requires further refinement, we do not believe that Ofgem, at that time, would have sufficient information to meet its test (set out in Section 2 of this consultation document) for demonstrating that third party competition would bring clear benefits to consumers. This can only be accurately assessed post-submission of the Technical (Costs & Outputs) information. Any earlier assessment could not have access to the full detail of the cost, scope and programme for delivery and therefore any decision to open the project to competition would certainly be premature.

5. The area of planning consents requires further consideration. In general, planning consents (including local authority, Scottish Government, wayleave, marine, Crown

Estate etc) are sought during pre-construction. In an ideal world, these will all be in place prior to submission of the Technical (Costs & Outputs) information. However, this is not always possible and consents will progress in parallel to the assessment of the Technical (Costs & Outputs) information. It is generally critical that these consents are sought as early in the process as possible as they have significant ability to delay the overall programme of delivery if they are delayed. In particular, any consenting areas which are particularly contentious, whilst preferably avoided in the first instance, are likely to cause delivery delay.

As previously mentioned, if, following Ofgem's consideration of the Technical (Costs & Outputs) submission, the project passes the test for competitive tender, the consents will ultimately need to be transferred to the successful bidder. There are number of potential issues with this arrangement which would need to be resolved, including –

- If the successful bidder proposes an alternative technical solution which results in changes to the design of the project (including route, substation site or configuration, programme, construction timetable, access routes etc), it is very likely that new consents will be required as existing ones may not be fit for purpose. New consents can only be sought once the successful bidder has been appointed. This may impact upon the delivery date of the reinforcement.
- Consents which are progressed by the existing TO may not be transferrable. In particular, wayleave and land lease agreements are specifically negotiated between the parties and may often require a full renegotiation if a third party TO was to become involved. This may impact on cost and delivery date.

6. One area which does not appear to have been captured in respect of the transfer of information and outputs to the third party TO, is the transfer of contractual obligations, in particular those obligations between the existing TO and the NETSO. For example, wider reinforcement works are often undertaken to facilitate generator connections and to deliver the existing TO's obligations under associated TOCAs. If the wider reinforcement works were no longer to be the responsibility of the existing TO, the obligations under the TOCA would have to be transferred to the third party TO, with them becoming effectively liable for delivery. It is not clear whether the existing contracts allow for transfer of obligations and if not, how Ofgem propose that this process should operate. Furthermore, the relevant licence condition which applies to this area is a PSO and, thus, not clear how this could be changed. It is not credible to think that a generator would accept a connection agreement with a potential for competition (in this area, the proposal is quite different from what has been developed in the OFTO regime). This has a substantial impact on both TO and generator and should be fully considered prior to progressing the implementation Ofgem's proposal.

7. As far as transferable pre-construction outputs, it is important that there is a high degree of completion prior to transfer. Lessons from the OFTO regime (particularly the failed tender of the Greater Gabbard project whilst it was part way through construction) have shown that it is virtually impossible to successfully transfer uncompleted construction works and we believe that the same applies to pre-construction outputs.

8. We expect that a transfer agreement for pre-construction outputs would be required but would welcome further opportunity to provide our views on this area. We understand that Ofgem will provide a firmer position on this matter during Spring 2012 and we intend to participate in that consultation at that time. However, in this regard, we note that a change to primary legislation was required in order to implement the asset transfer scheme for the OFTO regime and would welcome clarity on whether Ofgem intend to progress a similar change to primary legislation to implement such a scheme for onshore electricity transmission.

9. In order to ensure compliance with GB and EU requirements, we believe that any participating third party TO should obtain a transmission licence prior to entry into the competitive process rather than prior to participating in the transmission of electricity. This will lessen the risk of failure of the competitive process at a later stage should the third party TO be found to be incompatible with, in particular, Third Package arrangements. We do not believe it would be efficient for a third party TO to progress through the competitive tender process without confirmation that they are eligible to become a fully fledged TO if appointed.

10. There may be limited merit in allowing third party TOs to apply for an initial “light touch” licence prior to entering the competitive tender but the third party TO should be subject to a standard licence as soon as they have been appointed.

11. For the avoidance of doubt, we do not agree with Ofgem’s process as detailed in Figure 5. Whilst there may be merit in allowing a light touch licence throughout the tender process, 3rd package certification must be complete prior to entering the tender process and full licence conditions should apply once they have been appointed and prior to the commencement of any construction. The current TO licence obligations exist to safeguard consumers, particularly from the possibility of financial failure of a TO. This is clearly explained in Ofgem’s recent work on the ring-fence arrangements for network licensees and will apply to future transmission licensees as they will be a Protected Energy Company (PEC) under the 1989 Electricity Act. Any relaxation of licence obligations through a “light touch” licence will result in higher risk to the consumer. This is an area where we would welcome the completion, by Ofgem, of a cost-benefit assessment.

12. We note that the roles and responsibilities of the third party TO have not yet been consulted upon and this may influence the development of a light touch licence. We do not, at this time, see any transmission licensee obligation that might be removed or “watered down” for new entrants – we are particularly mindful of the

need to ensure an enduring solution is established from the outset and avoid the uncertainty that has pervaded the OFTO implementation. We intend to provide further views during the consultation on roles and responsibilities.

13. It is essential that the incumbent TOs are permitted to participate in the competitive tender process across GB, not limited by their existing geographic area. In this case, we welcome Ofgem's intention to assess bids on an objective and transparent basis. We believe that, out of the options presented in the consultation document, a ring-fenced arrangement within the existing organisation would best facilitate existing TOs participation in the competitive tender process. We expect that this would allow the ring-fenced part of the existing TO to compete on a level playing field. If it is deemed appropriate, following a cost-benefit assessment, that third party TOs are not subject to the same stringent financeability obligations that incumbent TOs are subject to, then the ring-fenced entity within the incumbent TO should also be relieved of these obligations.

14. It is important, however, that these ring-fenced arrangements still allow the TO to access efficiencies within the main TO business and we welcome Ofgem's recognition of this. Clearly this is an area which requires further consideration. We expect that Ofgem will consult further on how this ring-fenced arrangement might operate in practice and intend to provide further, more detailed views at this time.

Annex 1 – Process for funding Wider Reinforcement Works (from SHETL RIIO-T1 Business Plan)

BEFORE ASSESSMENT BEGINS (c.3 months)

Clear qualification criteria for wider works projects, all of the following to apply:

- Project elements or components must be inter-related to deliver a strategic wider works output; and
- In the main, projects will deliver a Strategic Wider Works Output defined in terms of an increase in transfer capacity across a defined transmission system boundary (as per SQSS criteria). It should be noted that not all large reinforcements cross defined transmission system boundaries, e.g. the large radial Island links such as Western Isles, Orkney, Shetland. In these cases the Output measure will be the capacity of the radial link itself. In other projects the reinforcement can cross multiple boundaries, e.g. Beauly-Denny, East Coast 400kV. In these cases the Output measure will be an increase in transfer capacity across several transmission system boundaries; and
- Capital cost of works for a given project will be greater than £50 million (2009/10 prices); and
- Excludes projects, or components of projects, already funded within the RIIO-T1 settlement or TII.

Cost allowance is 'totex' (sum capital and operating costs over RIIO-T1), capitalisation pre-determined; sharing factor pre-determined; financial assumptions (e.g. cost of capital, depreciation) as RIIO-T1 settlement

Notification period of intent to begin assessment:

- SHETL to report (every 6 months) on project timelines, specifically highlighting status of project drivers and expected assessment start dates.
- SHETL provide written confirmation of intent to begin assessment ("notification date"). The notification date must be at least 3 months prior to commencement of actual assessment period.

Within 3 months of the notification date, Ofgem confirm project meets qualification criteria

Within 3 months of the notification date, agreement (in principle) of timeline between Ofgem and SHETL (if appropriate in consultation with affected users) including key submission and decision dates for each part of the assessment in line with standard template, noting:

- Ofgem and SHETL retain scope to amend timeline from the standard template on project specific basis e.g. if needs case unusual, specific resource constraints occur etc.
- Timeline is only agreed in principle and might be subject to change, e.g. if more detailed work required, resource constraints etc.

By notification date, stakeholder notification of project and assessment timeline

- Following timeline agreement (in principle) between SHETL and Ofgem, stakeholder update to be published by SHETL.

Outcome: project qualification agreed and assessment timeline published

ASSESSMENT PERIOD (c.9 months)

Two-part assessment process: (i) needs case, and (ii) technical (including costs and outputs)

Needs case assessment to focus on -

- High level project scope
- Timing of delivery
- Environment, security benefits
- Value for money
- “Least regrets” analysis (where appropriate for projects that have a anticipatory element of sizing project for future needs)

Technical assessment to focus on –

- Detailed project scope
- Project execution plan
- Detailed cost estimates including risk mitigation costs
- Project outputs, including impact on wider RIIO primary outputs and secondary deliverables

Both project assessments may run in parallel where appropriate.

For both parts, clear submission requirements and assessment criteria (e.g. SQSS, strategic investment, user commitment) -

- Generic template to be implemented including information above:
  - Environmental benefits
  - Security benefits
  - Boundary capability
  - “Least regrets” analysis
  - Impact on and interaction with baseline capex and opex
  - Impact on and interaction with baseline outputs
  - Opex requirements for remainder of RIIO-T1 period

Where possible, use of joint consultants under standardised Terms of Reference

- Noting that Ofgem might need to seek separate consultant advice e.g. when project is considered along with consideration of a number of other non-SHETL projects

Both parties appoint project management for Q&A, consultants, meetings, etc.

- All submissions to be appropriately reviewed, approved and monitored within SHETL (SHETL Governance Processes)
- Clear document control responsibilities
- Clear lines of communication
- Regular and scheduled communication between Ofgem and SHETL
- Ongoing, informal communication between Ofgem and SHETL encouraged

Licence condition agreed at RIIO-T1 settlement on totex basis; schedule modified for project-specific costs and outputs as determined by the Authority.

Outcome: licence modification for annual totex cost allowance, and Strategic Wider Works output measures/

DURING CONSTRUCTION

SHETL required to submit annual reports (costs audited with accounts) as part of RRP during construction period and Ofgem responds as part of RRP process

- SHETL reports progress to stakeholders
- Ofgem incorporates into annual transmission report

Cost or output adjusting event (COTAE) provision in licence for prescribed circumstances. COTAE triggered by meeting both the materiality provision and the event provision.

1. Materiality provision

- Materiality of COTAE event >10% of total projected efficiently incurred project costs and/or where projected delivery date falls outwith the agreed financial year

2. Event provision

- Extreme weather (worse than 1 in 10 for land-based activity, equivalent provisions for marine-based activity); and/or
- Additional consent conditions or operational constraints imposed by statutory body (further planning consent conditions, environmental constraints, traffic management constraints, health and safety etc); and/or
- Movement of agreed outages by the system operator that impact on project cost/delivery – includes either removal or movement of outages; and/or
- Movement in scope for reasons which could not reasonably have been known at the point of two part assessment process (ground conditions, archaeology, protected flora and fauna discovered etc)

SHETL must also demonstrate that it has taken reasonable steps to mitigate the impact both before and after the event, taking into account customer impact and the penalty regime for non-delivery of outputs.

Baseline assumptions for all event provisions to be included in technical case submission (above).

Process, information requirements and timeline follows notification and assessment process described above.

Any COTAE will adjust revenue with a one year lag of when it is determined by the Authority.

On a totex basis, rather a project specific basis, Strategic Wider Works revenue will be adjusted annually with a two-year lag through the totex incentive.

Outcome: All parties able to monitor progress; amendments made (if required

and criteria met); totex incentive applied

AFTER CONSTRUCTION

SHETL notify Ofgem and stakeholders of delivery of output measures, and submit technical completion report

Within prescribed period (SHETL preference: 6 months), Ofgem confirm output measures have been met (actual expenditure deemed efficient, i.e. no ex-post efficiency assessment required); totex incentive continues to 'true-up' revenue and RAV based on actual expenditure

If within prescribed period (6 months), Ofgem advise output measures have not been met, Ofgem and SHETL to agree timeline for efficiency assessment within 3 month period, including key submission and decision dates.

Licence or accompanying RIGs set out criteria, process, information requirements and approach to assessing and directing impact of full or partial non-delivery of outputs –

- Clear criteria for determining penalty arrangements based on –
  - Whether non delivery of output measures was outwith SHETL's control
  - What customer detriment has been suffered
  - Extent of mitigation undertaken by SHETL
  - Actual expenditure and totex incentive reward/penalty
  - Calculation of penalty for non-delivery
  - Cap on maximum penalty (% of overall project costs)
- Assessment to take into account information which could reasonably have been known by SHETL at point of two part assessment process and the overall outturn at delivery date (e.g. if generators were expected to connect at a certain date which drives the project delivery date but the generators outturn late, this should be taken into account in assessing customer detriment and ultimately SHETL's penalty)

Outcome for delivering* penalty: Output measures delivered and RAV trued-up through totex incentive or clear process if output measures not delivered

3. SSE's response to the specific questions set out in the consultation document

Although we have provided our detailed views on Ofgem's proposal, please see below explicit responses to the questions set out in the consultation.

CHAPTER THREE

Question 1: 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 agree, in principle, that the changes proposed to industry codes are required in order to facilitate third party involvement in onshore electricity transmission. However, the detail of these code changes would be required before we are able to make a thorough assessment of whether the correct changes have been made. We expect further consultation in this area and intend to submit further views once the details of the proposed changes have been made available.

In addition to consideration of the necessary Significant Code Review, consideration must also be given to the other components of industry governance that will be impacted by the introduction of competition. Such governance includes, but is not limited to, licences (both current and those being drafted for the implementation of GD1 and T1 price controls), connection agreements, connection obligations and Statutory Instruments (including Guaranteed Standards).

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

As stated above, we agree that these changes may be required but before we can assess whether they are correct, further detail on the proposed changes is required. We expect further consultation once the detail of the proposed changes is available and we will submit further views at that time.

Question 3: Do stakeholders have further comments on the proposed process and timetable for enabling the industry code modifications?

Any code modification should follow already established procedures for code modification. With this in mind, the timetable Ofgem propose for enabling industry code modification appears very short. The expected timescale for a Significant Code Review is around 12 months. This alone is very close to the time proposed for implementation of the whole arrangement. We do not believe that the timescales set out are realistic and urge Ofgem to reconsider the timetable for code modification and implementation of the proposed arrangement.

CHAPTER FOUR

Question 1: What level of detail would be required for the following pre-construction outputs in order to hold an effective selection process:

- project design
- technical specifications
- route identification
- site studies
- environmental impact assessments and stakeholder consultation?

Both a high level of detail and completion would be required for the pre-construction outputs above in order to hold an effective selection process. A competitive process which involves half-finished outputs is likely to be unsuccessful, as experience from the OFTO regime has shown (Greater Gabbard initial tender process). However, providing that the decision to implement competition is made at the appropriate time (i.e. post-submission of the Technical (Costs & Outputs) information to Ofgem), it would be expected that a substantial proportion of these pre-construction outputs would be complete.

Question 2: Should planning consents be in place before the selection process?

Yes, planning consents should be in place before the selection process commences. This allows any potential bidder to understand the consent conditions which have been imposed and ensure that appropriate allowance is made for such conditions.

Question 3: Should land be purchased or wayleaves obtained by the incumbent TO before the selection process?

Yes, land should be purchased and wayleaves obtained by the incumbent TO before the selection process. This is primarily because these activities are often a prerequisite to the granting of planning consents, which should also be in place prior to any selection process.

Question 4: 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?

It is entirely appropriate that, as is the case currently, Ofgem seek independent verification of the needs case and solution proposed by the incumbent TO. This is defined in the RIIO-T1 Strategic Wider Works funding process as detailed in Annex 1. However, given that the outcome of that independent verification may be prior to the submission of the Technical (Costs & Outputs) information to Ofgem, it cannot solely inform a decision to submit the project to the competitive process.

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?

In most cases, we expect that the pre-construction outputs would be transferred to the appointed third party TO. However, the commercial sensitivity of such outputs must be considered in order to inform the optimum time for transfer to a third party. Additionally, it is important that any risk arising from the transfer of pre-construction outputs is correctly allocated. Equally, consideration must be given to any liabilities arising from the transfer of pre-construction outputs, particularly in the area of route survey information both onshore and marine. Clear regulatory guidance in this area is essential.

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 agree that an arrangement will be required in order to facilitate the transfer of pre-construction outputs but it is not clear at this stage what the detail of such an arrangement should look like. We expect to provide further views in this area as the development of Ofgem's proposal progresses.

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 agree that there is merit in allowing third party TOs to maintain a "light touch" licence during the tender process but it is critical that any third party TO successfully obtains Third Package Certification prior to engaging in the tender process, otherwise there is a risk that the tender process fails at a late stage, thereby delaying the delivery of the reinforcement. Furthermore, we expect that the "light touch" licence would become a full transmission licence once the third party TO has been appointed (i.e. prior to actual construction).

Without having access to the detail of a proposed "light touch" licence, it is not yet possible to assess whether this licence will be fully effective. The risks to consumers of allowing a "light touch" licence post competitive appointment should also be assessed prior to progressing this proposal. The current obligations, particularly those relating to financing, are in place to protect consumers from the failure of the TO. It is not clear how the risks to consumers would be managed in the event that these obligations were relaxed.

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

We are not clear exactly what is meant by this question. If further business separation arrangements are to be imposed on incumbent TOs, we expect that a cost-benefit analysis would be carried out by Ofgem prior to the implementation of such arrangements.

If the suggestion is that a business separation arrangement would bring the ring-fenced part of incumbent TOs on to a level playing-field, particularly in relation to financeability, with third party TOs, then this proposal may be worth further investigation. However, it may not require business separation arrangements if a licence condition is "turned on" for incumbent TOs when participating in the competitive process which allows the relaxation of financeability obligations in relation to the incumbent TOs competitive activity.

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

If it is decided that business separation arrangements are required, a ring-fenced entity within the existing licensee is most appropriate. This negates the need for the incumbent TO to seek a specific "third party" licence. The ring-fencing should only have the effect of keeping the financing of competitive activity separate from the financing of the existing transmission activities. However, it is important that the ring-fenced entity is able to access resources within the rest of the licensed business to ensure efficiencies and synergies are utilised. Without this access, the cost of delivering the wider reinforcement works, and ultimately the cost to consumers, would certainly be increased.