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Dear Jon,

ITPR Draft Conclusions

SSE welcomes the opportunity to respond to Ofgem's draft conclusions on the Integrated Transmission Planning and Regulation (ITPR) Project. We continue to be supportive of reforms to the regulatory framework that enable a more integrated and efficient approach to the development of the transmission system in Great Britain (GB). However, it is important that any changes proposed clearly demonstrate the benefits, have a clear timetable that supports timely investments, and have broad support from affected stakeholders.

In this regard, whilst we remain supportive of the proposals for an enhanced system operator role, we are very concerned about the proposals for competition contained within the draft conclusions. The existing process for developing the onshore transmission network is complex, with multiple interactions between the Transmission Owner (TO), developers, the System Operator (SO) and Ofgem. Adding further complexity will increase costs to customers and delay project delivery. Furthermore, there is a suite of practical issues that have yet to be addressed or costed including, but not limited to: licencing, liabilities, transfer of property rights and the detail of implementation and management of the tender process. Given these issues, and the level of pre-construction work carried out on planned projects to-date, we are very firmly of the view that projects identified for delivery within RIIO-T1 cannot be considered for competitive tendering.

In addition to the above, we are disappointed that the opportunity to establish a single, GB-wide regulatory regime for all transmission assets has not been taken forward; and we continue to have concerns about adequate separation between the SO and TO roles within National Grid Electricity Transmission (NGET).

To be clear, as the proposals currently stand they will introduce additional costs to customer bills, introduce significant uncertainty for developers and result in delays and additional costs to urgently needed transmission projects. We would suggest, therefore, that Ofgem needs to look again at:

- The timing and benefits of introducing competitive delivery, including full regulatory impact assessment, clearly defined criteria and, importantly, a realistic timeline;
- A single regulatory regime for all transmission assets; and
- Business separation requirements between the SO & TO within NGET.

This letter provides a summary of our views, with our responses to the consultation questions attached at Appendix 1.

General

As previously set out, it is our view that a number of the issues identified by Ofgem under this project could be resolved by establishing a single, GB-wide regulatory regime for all transmission assets, including interconnectors. In retaining existing, artificial distinctions, barriers are created, albeit inadvertently, to the development of a fully co-ordinated transmission system that encompasses onshore, offshore and interconnection assets. Without addressing this fundamental issue, the reforms proposed by ITPR target symptoms, rather than the root cause.

Enhanced system operator role

We generally welcome the proposals for an enhanced SO role and believe it builds upon existing cooperation within the industry. It is essential that investment decisions and detailed design rests with the transmission owner and, hence, we welcome confirmation of this. We also appreciate confirmation that this role will not change the role of user decisions and price signals in informing the planning of the network: an important aspect of transmission planning.

We see merit in enhanced SO and TO liaison and believe that all relevant parties should be involved in developing the Network Options Assessment (NOA) and reviewing the System Operator – Transmission Owner Code (STC) to give effect to this. The enhanced SO function should facilitate greater co-ordination, not less, and the collaborative NOA should be the first step in this.

Competitive delivery

There are a number of essential prerequisites for fundamental reform to the regulatory framework as envisaged by competitive delivery. In the first instance, strong customer benefit must be demonstrated. Further existing investment requirements must be met without delay or increased cost. Finally, the new approach must be set out in detail, be well understood by all affected parties, and be viewed as fair and transparent.

(i) Strong customer benefit

At this stage, we do not believe sufficient work has been undertaken to demonstrate whether there is a genuine need and the associated costs are offset by customer benefit. The existing process for developing the onshore transmission network is complex, with multiple interactions between the Transmission Owner (TO), developers, the System Operator (SO) and Ofgem. Adding further complexity will increase costs to customers and delay project delivery. It is essential, therefore, that the benefits are clear and demonstrable. As such a rigorous regulatory Impact Assessment of the detail of this proposal and the benefits it is anticipated to deliver for consumers needs to be undertaken.

Given the scale of the work likely to be required by Ofgem, Government and the industry to deliver these proposals, there needs to be demonstrable evidence that competition will bring benefits to GB consumers. This has not been demonstrated to-date.

(ii) Existing investment requirements

Ofgem has identified the earliest opportunity for the tendering regime to take effect as 2016/17. Given the relatively limited work to-date, and scale of change required going forward, this timescale is considered ambitious.

Transmission infrastructure is a considerable investment, highly dependent on demonstrable customer need, and requires a significant time commitment to ensure a solution is developed that meets customer need. It must also be realistic within the constraints, such as planning, land access and supply chain availability, which affect large infrastructure projects. For those customers, whose own projects hinge on such infrastructure works, maintaining timely and efficient delivery in transmission investment on an understood basis are essential to ensuring the viability of their own projects.

To this end, we do not believe it is acceptable or appropriate for projects where pre-construction works are well developed, and delivery is required within the RIIO-T1 period, to be subject to competitive delivery. For SHE Transmission, the investment within this description are the East Coast project, the Western Isles link and the Shetland link¹. Consideration of these projects for competitive delivery would result in delays and increased costs to the generation customers whose needs they are responding to. This is clearly not fair or reasonable.

(iii) Developing a new approach

In developing fundamental reforms to the prevailing regulatory arrangements, it is important that the proposed new arrangements are subject to detailed consideration and consultation to ensure that they can be fully understood and parties can assess whether or not they are suitable. To this end, we believe that there is still significant work required to develop Ofgem's proposals to a position that all affected parties can fully assess their potential impact.

Based on Ofgem's thinking to date, we have the following observations: firstly, there appears to be a suite of practical issues that have yet to be addressed e.g. development of a new licencing regime, treatment of liabilities, the practical aspects of implementing the new regime and how the tender process is to be managed. Furthermore, the potential transfer of property rights will most likely require changes to primary and/or hybrid legislation.

Secondly, it is essential that Ofgem, as the National Regulatory Authority, retains the decision-making role for whether or not a project meets the criteria for tendering. And, thirdly, given the small number of parties that have capability to deliver such works, it is essential that any proposals are implemented in a manner that does not preclude existing transmission owners from participating.

We recognise that competitive delivery is 'work in progress' and that further consultation is planned during 2015. Given the issues raised above we would urge Ofgem to develop and share a comprehensive plan, with stakeholder engagement, for this fundamental reform to the regulatory framework. We look forward to working with Ofgem and other Industry parties to further develop thinking in this area.

¹ Projects where funding has already been agreed, or is subject to the final stages of the Strategic Wider Works assessment process, are inherently too far developed to be suitable for competitive tendering.

Mitigating conflicts of interest

We welcome Ofgem's recognition that conflicts of interests do need to be mitigated but believe it is essential that appropriate safeguards are introduced between the SO and TO functions within NGET, as well as between NGET and National Grid's other competitive businesses. Given that the industry is accustomed to separation between SO and TOs in Scotland, it is our view that similar arrangements could, with minimal disruption and little impact on the synergies identified in previous consultations, be applied in England and Wales.

Transparency and good governance around the interface between the SO and Ofgem are also required as part of mitigating actual or perceived conflicts of interest.

Summary

Whilst we are supportive of an enhanced SO role to enable a more integrated and efficient approach to the development of the transmission system in GB, we have serious concerns about the current proposals for competitive delivery of on-shore transmission assets.

As the proposals currently stand they will introduce additional costs to customer bills, introduce significant uncertainty for developers and result in delays and additional costs to urgently needed transmission projects. Ofgem needs to look again at the timing and benefits of introducing competitive delivery, including full regulatory impact assessment, clearly defined criteria and, importantly, a realistic timeline.

We will continue our engagement with Ofgem and industry on ITPR via the current licence drafting working groups and, importantly, any other workshops/groups established as the proposals for competitive delivery are further developed. In the meantime, if you require any further information from us to assist you in reviewing our response, please do not hesitate to contact me.

Yours sincerely,

Malcolm J. Burns

Senior Regulation Manager

Appendix 1: Response to specific consultation questions

CHAPTER: Two

Qu 1: What are your views on our proposed enhancements to the SO role in system planning, including the specific roles we have proposed the SO would undertake for onshore, offshore and interconnection planning?

We generally welcome the proposals set out within the Draft Consultation and believe it builds on the existing cooperation between the SO, TOs (both on- and off-shore), Interconnector Operators, Distribution Network Owners, relevant project developers and other interested parties. Work to date developing the economic appraisal and preferred investment option for the East Coast project by SHE Transmission and Scottish Power Transmission is being underpinned by analysis undertaken by the SO, for example. Providing a formalised basis for such analysis and joint working will, in our view, improve consumers' confidence in the investment decision making process. As such, we are supportive of an enhanced SO role that takes an overarching, generic view of system need, in support of the local transmission owner.

We welcome the proposal that investment decisions and detailed design rests with the TO. We also appreciate confirmation that this role will not change the role of user decisions and price signals in informing the planning of the network: an important aspect of transmission planning.

There are already well established mechanisms in place, predominantly under the System Operator – Transmission Owner Code (STC), to provide for communication between the SO and TOs, both on- and off-shore. It is our view that these mechanisms should be utilised, albeit with appropriate modification to reflect the revised role of the SO, wherever possible. This will assist in the transition and ensure that no duplication of activities is inadvertently created. We look forward to working with the other signatories to the STC to review any amendments that may be required to give effect to the enhanced SO role.

We welcome the proposals around increased transparency. However, we believe it is essential that there is a clear delineation of the SO's role, particularly in relation to providing advice or recommendations to Ofgem, with appropriate mechanisms established to challenge the view of the SO in the same way as already exists for the TOs and Ofgem. Such mechanisms should include greater transparency around the nature and timing of information provision, as well as requirements to consult upon and consider the feedback of affected parties prior to providing such advice or recommendations.

We believe the proposed Network Options Assessment (NOA) process has the potential to deliver benefits, although the detail of this process is likely to be critical to its success. As such, we look forward to working with Ofgem and other industry parties to develop the detail of this process.

The consultation document also flags a number of other areas where further changes to the SO role may be beneficial, namely in relation to connections, outages and power quality. Given the limited information on the identified concerns provided within the consultation document, we would welcome further discussion and/or consultation on the nature of the concerns identified and a holistic approach to identifying the most appropriate solution to address these.

Qu 2: Are there other roles that you think an enhanced SO could or should undertake in order to better support the development of an efficient transmission and interconnector network?

At this stage, we do not believe there are many other significant roles that an SO could or should undertake. However, as set out in response to question 3, it is our view that the STC provides an effective and workable mechanism that can be used to implement the proposed enhanced SO, with mechanisms in place to extend the interactions if identified as having the potential to deliver additional benefits.

One area where there may be benefits is if the SO participated in ENTSO-E's evaluation of the justification for interconnection with mainland Europe.

Qu 3: What are your views on the specific obligations for TOs that might be needed to support our proposed enhanced SO role?

As described in response to question 1, we believe that a number of the proposals build on existing relationships and frameworks and recommend that these are used to deliver the policy wherever appropriate. In particular, we believe that the STC is the most appropriate medium for developing these arrangements to ensure an appropriate balance between meeting the additional needs of the SO, whilst given due consideration to what the transmission owners (both on- and off-shore) can reasonably provide.

One example of this is in relation to technical assurance of proposed projects. Technical assurance of solutions is essential to avoid emergence of serious system issues at a point in project development or delivery much further down the line. For example, where significant portions of underground or subsea AC cable are involved, detailed modelling and assessment of harmonic resonances prior to committing to the solution is necessary because in some cases there are few options for remedial work to manage the issue. The system could fundamentally be inoperable. In our view, the SO has oversight of the system and any potential high-level concerns but the onus for technical assurance of solutions being offered should rest with the transmission owner proposing a given solution.

It should be noted that there may be additional costs incurred by the transmission owners in meeting these requirements and, to date, no consideration has been given to these. However, these costs are beyond anything that could be reasonably foreseen at the time of developing the RIIO-T1 Business Plans. An additional category within the Uncertain Costs condition may be an appropriate mechanism to ensure these costs are captured within the prevailing price control.

Qu 4: What are your views on our proposal that, as part of its enhanced role, the SO should lead gateway assessments for offshore projects that include investment to provide wider network benefit?

We see some merit in the proposal but recommend that the detail needs to be further development in line with the Strategic Wider Works (SWW) and NOA processes to ensure a consistent approach is adopted, irrespective of the regulatory regime that applies. As such, we look forward to working with Ofgem and other industry parties on the detail in due course.

CHAPTER: Three

Qu 5: What are your views on our proposal to extend competitive tendering to new, high value, separable onshore assets?

As described above, we believe there are three key areas that these proposals need to address and, to date, we do not believe that these have been met fully.

(i) Strong customer benefit

We do not believe sufficient work has been undertaken to demonstrate whether there is a genuine need for competitive delivery for transmission investment and the associated costs are offset by genuine and achievable customer benefit. . The existing process for developing the onshore transmission network is complex, with multiple interactions between the Transmission Owner (TO), developers, the System Operator (SO) and Ofgem. Adding further complexity will increase costs to customers and delay project delivery. It is essential, therefore, that the benefits are clear and demonstrable.

As such, a rigorous regulatory Impact Assessment of the detail of this proposal, the assumptions that underpin it, and the benefits it is anticipated to deliver for consumers needs to be undertaken. Given the scale of the work likely to be required by Ofgem, Government and the industry to deliver these proposals and the potential uncertainty it introduces for customers, there needs to be strong, demonstrable evidence that competition will bring benefits to GB consumers.

Whilst the design and development of transmission projects are undertaken by the transmission owners, the actual construction of these assets is already subject to competition in the form of competitive tendering for delivery. Given the relatively small number of parties that have the capabilities required to construct transmission assets in a safe, efficient, and timely manner, we are unclear where Ofgem anticipates further efficiencies will accrue. The lack of a detailed Impact Assessment limits our ability to comment on whether or not this has been fully incorporated into Ofgem's current thinking.

We are also concerned that many of the examples provided in the consultation of where competition in transmission has been seen to work internationally are not necessarily applicable in the GB context. We also believe that a distinction should be drawn between the existing offshore transmission regime whereby all offshore assets to date have been generator-builds and the proposal that parties tender for the design, develop and build of transmission assets, as well as the operation and maintenance. As a result, the cost savings observed may not necessarily be transferable to a wider context.

(ii) Existing investment requirements

Ofgem has identified the earliest opportunity for the tendering regime to take effect as 2016/17. Given the change required, this timescale may be ambitious, resulting in the regime coming into effect after this date. Whilst we acknowledge Ofgem's comments in the RIIO-T1 Final Proposals, we do not believe it is appropriate for projects currently within pre-construction to be considered within any competitive delivery framework. Potential projects can only be identified and appropriately assessed as to their suitability for tendering once the details of any competitive delivery framework are finalised.

Consideration of projects where pre-construction works are well developed and delivery is required within the RIIO-T1 period as potential early contenders for competitive delivery will result in increased uncertainty, costs and/or delays that are unlikely to benefit consumers. As set out above, the projects that this is likely to include for SHE Transmission are the East Coast project, the Western Isles link and the Shetland link.

Ofgem needs to be aware in developing its thinking that differences in Scots law, as compared to English law, are likely to have a significant impact on the implications of attempting to introduce competitive delivery to these projects. Rights acquired under wayleaves and deeds of servitude, for example, under land law in Scotland cannot easily be transferred or novated and a third party may be required to reacquire these rights, adding potential delays to a project's timeline.

Importantly, further work is required to fully define the criteria for those works likely to be tendered to provide industry-wide certainty and understanding on the implications for projects driving the transmission works. We look forward to working with Ofgem and others on the development of appropriate criteria.

(iii) Developing a new approach

We note that the section on competitive delivery is a work in progress and agree that this is a complex area that needs further work. It is essential that the new arrangements are set out in detail, well understood by all affected parties, and viewed by all as fair and transparent.

We agree that any proposals are likely to require legislative change and full consideration of the nature of the legislative change is required to ensure effective implementation. However, there are a number of interactions within this. The exact nature and timing of a delivery model is likely to have a significant impact on legislative change, in terms of which party is responsible for acquiring land rights for example. The potential transfer of property rights will most likely require changes to primary and/or hybrid legislation. This work, in turns needs to inform, and potentially revise, the Impact Assessment as the approach taken to tendering may have an impact on land costs (in this example). Furthermore, there appears to be a suite of practical issues that have yet to be addressed e.g. development of a new licencing regime, treatment of liabilities, the practical aspects of implementing the new regime and how the tender process is to be managed.

We look forward to working with Ofgem and the industry as the thinking on the competitive delivery is further developed.

In the event, that competition is introduced, it is essential that the decision as to what is tendered remains ultimately with Ofgem as the National Regulatory Authority. Such decision making needs to be appropriately resourced to understand the technical and wider economic issues associated with such a decision. We do not believe it is appropriate for the SO to be given responsibility for such decisions; this would only be appropriate with a fully Independent SO.

To ensure the maximum number of eligible parties that could participate in any competitive activity, it is essential that any changes introduced to primary legislation and industry governance do not preclude the participation of existing TOs. As described above, there is a relatively small pool of potential parties with the capabilities to deliver infrastructure on this scale and it is essential that this is not further concentrated.

Qu 6: What are your views on our proposals to maintain a developer-led approach to interconnection and to extend the cap and floor regime?

As set out in our response to the consultation on the cap and floor regime, we do not believe these proposals will be in the best interests of consumers in the longer-term. It is our view that interconnection should be considered transmission assets and regulated accordingly. The failure to bring Interconnectors fully in to the regulatory field perpetuates the mismatch of regulatory assets.

Removal of artificial distinctions between categories of transmission asset would address barriers identified previously by Ofgem and facilitate a more integrated system, with fewer perverse incentives arising from the differences between the different regulatory regimes.

Regulatory treatment of these assets is likely to result in a lower cost of capital and, as such, it is essential that the assumptions underpinning the use of a cap and floor regime be tested against the regulatory treatment of these assets, as part of a detailed impact assessment.

In addition, complexities arise when considering interconnection at a European level as a result of the GB approach to funding interconnection. We do not believe a convincing argument has been presented for going against the prevailing norm.

Qu 7: What are your views on our proposal that non-GB generators pay for their connections, without consumer underwriting?

We tend to support this approach but believe it is appropriate that such instances are considered, and consulted, on a case-by-case basis.

Qu 8: What are your views on our proposal to provide regulatory continuity when the purpose of a transmission asset changes?

For parties considering investing in long term assets, like electricity transmission but also generation developers, regulatory continuity is a fundamental consideration in assessing the risk, and subsequent return, associated with such an investment. We welcome the proposal to provide regulatory continuity and, as such, it is our view that all interested parties should be no worse off in the event that a change in the purpose of a given asset is required.

As discussed in relation to question 6, removal of artificial distinctions between categories of transmission asset would further reduce the risk of any potential need for projects to be considered under multiple regimes.

The detail on any specific proposal is likely to be critical in order to fully address this issue and may be difficult to codify. As such, we are willing to work with Ofgem and the industry on any arising matter to ensure an effective outcome.

CHAPTER: Four

Qu 9: What are your views on our assessment of conflicts of interest?

We agree with the assessment of how conflicts of interest may arise as a result of the enhanced SO role. However, we are concerned that the potential impacts of such conflicts are underestimated. We believe it is essential to ensure confidence in the overall regime that steps are taken to ensure both actual and perceived conflicts of interest are appropriately and adequately mitigated.

If one considers the interface across the Scottish – English boundary, for example, the SO is required to consider how best to manage boundary flows and outages on a constrained system. As a result, there is already a potential conflict of interest as granting outages for the English transmission owner, which may be required to allow completion of its investment, is likely to limit availability of access to the network for one or more of the Scottish TOs. The proposed enhanced SO role is likely to exacerbate the existing situation.

When the developments proposed under ITPR are considered against the wider policy background, it is clear that the role of SO has fundamentally evolved from that envisaged at the time of BETTA. As such, we believe it is essential that a proper review of the SO functions are undertaken and appropriate amendments made to both its licence and its incentives arrangements to ensure that the role is appropriately regulated and incentivised to meet the needs of all parties.

Qu 10: What are your views on our proposals for mitigating conflicts of interest?

We welcome Ofgem's recognition that steps are required to mitigate conflicts of interest. In general, these proposals, in conjunction with existing requirements on NGET's interactions with its relevant associated competitive businesses, should assist in mitigating some of the identified potential conflicts. However, further consideration is required regarding the degree of business separation between the SO and TO functions within NGET. This is particularly sensitive in light of the proposal in para 2.55 that the SO is involved in the development of investment plans for RIIO-T2.

In order to carry out its increased functions, and particularly in the event that competitive tendering is realised, the SO will be privy to increased information about other participants within the industry. Access to this information, without commensurate business separation arrangements, conveys an advantage to NGET's transmission owner function that is not available to other parties within the industry.

Given that the industry is accustomed to separation between SO and TOs in Scotland, it is our view that similar arrangements could, with minimal disruption and little impact on the synergies identified in previous consultations, be applied in England and Wales. Such an approach could be achieved, for example, by splitting NGET's special conditions according to function and increased transparency as to where one function ends and the other begins. We welcome more effective engagement with the third onshore TO in GB, as well as the SO.

Qu 11: Do you think independent scrutiny of the SO's activities (eg through an expert panel or auditors) would provide value for money?

It is our view that appropriate systems and processes are essential to ensure industry confidence in the revised arrangements. To the extent that such arrangements are not forthcoming or Ofgem (or industry parties) are concerned that the arrangements are insufficient, independent scrutiny may be needed to ensure all parties are confident that the arrangements are operating in an equitable manner.

In addition, we believe that the enhanced SO role does require a dispute resolution mechanism. In the event that the SO, for example, recommends a TO undertakes a commercial solution and the TO remains concerned that such a solution has the potential to have a negative impact on its network that the SO has not given due cognisance to, there needs to be a formal mechanism to resolve such disputes. This is of particular concern given the wider range of voltages that transmission operates at in Scotland. Independent scrutiny may be beneficial in such instances to ensure that the SO acts on such concerns from interested and/or affected parties.

In addition to any independent scrutiny, we believe that it is imperative that Ofgem has appropriate in-house resource to be able to robustly challenge the information and recommendation provided by the SO. Transparency and good governance around the interface between the SO and Ofgem are also required as part of mitigating actual or perceived conflicts of interest.