SP ENERGY NETWORKS

Regulation & Commercial

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Date: 24th November 2014
Contact: Alvaro Ryan
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Dear Jon,

Integrated Transmission Planning and Regulation (ITPR) project: draft conclusions

This response is from SP Transmission plc (SPT) the onshore Transmission Owner (TO) for the South of Scotland. As a TO we must ensure that we develop an economic, efficient and coordinated onshore transmission system. We therefore welcome the opportunity to comment on Ofgem's ITPR project draft conclusions.

The way that we design, build and coordinate the development of the GB Grid (under NETS SQSS) has underwritten a level of system security that is unprecedented. Furthermore, according to Eurostat figures[1], UK system charges are among the most efficient in Europe. We believe that existing arrangements have served customers well and the changes proposed under these draft conclusions present a potential risk to the security and reliability of the Transmission system that is not justified by a clearly stated quantifiable economic benefit.

Competition already exists within the delivery of onshore transmission investment through the increasing development of global competition within the supply chain by all three existing onshore Transmission Owners. Typically, any major project delivered involves 80-90% of the activity being competitively tendered.

Unlike the imminent challenges we will face in the coming years in generation activity, there is no sign that the market is failing to deliver in terms of the onshore grid. In addition, the strength of the UK regulatory regime in terms of monitoring and separation of the transmission business from other regulated and non-regulated business areas has been recognised by the European Commission and is further recognised by the derogation obtained by SPT from full unbundling.

There are good working relationship with existing onshore TO's including sharing of spare parts, black start and storm response arrangements, consistent and robust engineering standards and design specifications. New entrants should be willing to engage in this same cooperation to ensure these good operational working practices continue for the benefit of consumers. Any new arrangements as proposed by this consultation will need to be implemented within the onshore TO market in a manner so as to avoid jeopardising the significant benefits to GB consumers of the current arrangements in terms of economic benefit and security of supply

[1] See "Energy prices and costs in Europe" published in January 2014 by the European Commission.

This final consultation has little, relevant cost-benefit analysis that demonstrates the proposed changes will benefit the consumer. Nor is there proper consideration of the risks and issues that must be resolved so that stakeholders can make an informed response to the proposals. Implementing onshore competition in particular requires further analysis of the potential savings beyond those already achieved in existing TO tendering processes, against the increased costs of implementing the tender process and new governance, operational and interface costs.

A full risk assessment is also crucial, as this proposal could, subject to further details being provided, potentially lead to lengthy delays in delivering key infrastructure and the operation of the GB system will become much more complex. For example some consideration must be given to the optimum number of players that should exist in a Transmission zone or territory that can operate effectively and ensure coordination and security of the Grid is maintained.

The draft conclusions do not provide sufficient clarity on roles, responsibilities and rules of the proposed new regulatory framework. Any new regulatory scheme must guarantee a level playing field for all, especially in respect of their remuneration, incentives and obligations; particularly if the proposals are to form an integral part of any future transmission price controls. It is not clear how this will be achieved. For example, there is limited explanation of how tenders will work or the parameters governing the cost of capital that the awarded parties will be subject to. Nor is it clear what the eligibility criteria for new entrants will be (which must be transparent and be as robust as those applicable to existing TO), nor how Ofgem will guarantee a coordinated approach to system operation when more and more players interconnect in the same area.

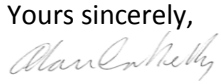
There is no mention of a dispute procedure and the new roles and processes will lead to disagreements on planning decisions, tender awards or conflict of interests between parties. A suitable procedure needs to be developed.

Therefore, we recommend that further work is required to develop these proposals and further consultation is necessary. In our opinion, consumers demand a proper quantitative impact of the proposed changes that demonstrates that they will be beneficial to them. We have provided answers to your specific questions in appendix 1.

Transmission infrastructure is of key strategic importance to the UK's security of supply and economic development, we recommend that Ofgem must demonstrate empirically the impact of the relevant changes that they are proposing in their draft conclusions. We believe that it's necessary to assess the draft conclusions further, especially regarding the enhanced role for the System Operator and any potential conflict of interest created by such an enhanced role, and the proposal for onshore tendering.

We appreciate the effort Ofgem have made to engage with SPT and other stakeholders in regard to this consultation and are grateful for the ongoing opportunity to engage with this important process. We look forward to contributing further but please do not hesitate to contact myself or Alvaro Ryan should you have any queries in the meantime.

Yours sincerely,



Alan Kelly
Head of Transmission Regulation and Commercial Policy
SP Energy Networks

Appendix 1: Responses to Questions

CHAPTER 2: Enhancing the System Operator's role in system planning

Question 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 recognise there are some potential benefits to establishing an enhanced SO role, if this consolidates the informal arrangements that exist currently such as the ENSG group that has developed effective UK wide solutions that we are delivering in the current price control period and will achieve the increased capability in the Transmission system in our area to develop a low carbon energy system. The enhanced SO role must support and be enshrined within the formal arrangements under the system operator-transmission owner code (STC) such as the Joint Planning Committee (JPC), and the development of the Future energy Scenarios and Energy Ten Year Statement (ETYS). Specific functions of the SO role should include providing economic analysis to support the TO's development of investment and optioneering process, and they should be funded for that through their price control. Clarity is required on the level of support and timescales for delivery the SO needs to achieve.

The draft conclusions make clear the enhanced SO role is to support the local TO in identifying and developing its onshore transmission options decision and business plan development. We welcome this and consider the best interest of current and future consumers will be served if investment decisions and detailed design continue to rest in the hands of the incumbent TO's, suitably supported by the SO. We would emphasise that to some extent this already conforms to the existing framework between the Scottish TOs and the SO

An enhanced SO can achieve formalised overarching, objective view of the system that will help ensure better coordination across different parts of the network and could help the development of the network in a more efficient way. However, the benefits to consumers over existing arrangements compared to the cost of implementing this role and potential risks that may arise have not been demonstrated. Further analysis of the benefits and risks should be undertaken. More clarity and detail on the roles, responsibilities and processes involved in establishing an enhanced SO role is also required.

Question 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?

The SO should have a more active role in identifying potential new developments related to interconnectors,. In the proposal, it is stated that developers should bring forward proposals for new interconnection capacity and that the SO would develop options for where the interconnector should connect to the GB network.

We believe that the SO should have a more active role, identifying potential future interconnection needs and sharing its analysis through the NOA process. We would suggest, however that the proposed NOA process itself would benefit from more detail. This new role will reinforce the overarching view of the system and will allow a more efficient and timely development of interconnections.

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

The incumbent onshore TOs in the UK have played a very significant role to contribute to the overall objective of planning the transmission network in an economic, efficient and coordinated manner. For example, SPT developed, with NGET the England to Scotland interconnectors and we are uprating this boundary (B6) transfer capacity to 6.6 GW with the delivery of the Western HVDC offshore link. We developed the Beauly-Denny uprating with SHE transmission that will achieve a 1.2 GW increase in the boundary B4. Working with NGET and SHE Transmission have identified and developed the proposal for an Eastern HVDC bootstrap and are working currently on preparation for the joint East Coast/Central project. The knowledge and skills that the TO's have accumulated should be maintained and not lost.

There is limited explanation of the specific obligations TO's are expected to fulfil, however these do confirm that identification and responsibility for developing onshore transmission options rests with the incumbent TO. We welcome this. Furthermore that TO's are expected to provide the SO with information on their investment plans and data on their network. Also that the TO's will deliver certain options and should take into account possible co-ordination with other TO's in their optioneering process. These are existing obligations generally codified in the STC and already delivered by the TO's. Any enhanced information provision obligations should be reflected adequately in the STC.

Another issue which is not clearly addressed in the current consultation is the role of the incumbent TO as TO of last resort. We consider that if SPT has any sort of obligations regarding this duty in the future, is should be adequately addressed and the proposals consulted upon. The role of TO of last resort must also be adequately accounted for in any future transmission price control.

In relation to the proposed NOA process lead by the SO, we think that the TO should have a pro-active role in it. The proposal sets out that the SO will provide its assessment based on the TOs data, but we believe that both parties should help to develop the NOA in an interactive way.

Regarding obligations for the TO on information exchange we consider we fulfil these currently. However, these must also require the SO to provide information, as exchanged is necessary both ways. For example, constraint costs, system information and generator data. This may require updating the current provisions in the STC.

Question 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 agree with this proposal in general terms, and recognise it is important the SO is able to implement investment that has wider network benefits based on the NOA process.

CHAPTER 3: Regulating asset delivery

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

This final consultation has no detailed cost-benefit analysis that demonstrates that the proposed changes benefit the consumer, together with a proper consideration of the risks and issues that must be resolved so that stakeholders can make an informed response to it. We consider that proposing onshore tendering should only be raised after a careful analysis of the savings (beyond those already achieved in existing TO tendering processes) and costs (tender itself, ongoing and interface costs).

In making this CBA assessment, we must realize that the actual level of efficiency of the UK onshore TO is much higher (due to actual procurement processes) that the existing in all of the examples described in figure 7 (Appendix 5). In many of the countries listed in that table, the regulatory regimes that TOs withstand do not incentivize efficient investments at all, whereas the UK regime strongly does. This must be indicative that the relative potential savings of onshore transmission tenders in the UK will be much smaller than the examples shown.

Risk assessment is also crucial as hidden costs and risks may appear, as this proposal could lead to lengthy delays in delivering key infrastructure and the operation of the GB system will become much more complex. It's essential that the long term benefits and costs of a densely disaggregated network are analysed. This should include consideration of the optimum number of players that can operate in a Transmission zone or territory that will achieve operational effectiveness and ensure coordination and security of the grid is maintained.

If tenders are demonstrated to be beneficial for customers, it should be Ofgem and not the SO who must decide if a project meets the tendering criteria or not. This will also further mitigate potential for conflict of interest within the SO entity.

Any new regulatory scheme must guarantee a level playing field for all, especially in respect of their remuneration, incentives and obligations. Greater clarity is required on eligibility criteria for new entrants will apply. The current proposals do not yet adequately address the differences in financial and operational motivations and requirements between the incumbent TOs and new entrants.

Regarding the two tender models proposed (early CATO and late CATO build), we believe that only the first one of them should be implemented. One model would make the process more predictable for all parties, and the late CATO build model assigns the SO certain roles that in our opinion it should not undertake, particularly consenting. The early model encourages innovation (and thereby potentially long term value) while the late model provides no benefit other than cost.

Tendering creates uncertainty, raises questions on liability and risk and inevitable delays in the process. The cost of tenders needs to be fully understood and the benefits demonstrated to outweigh these costs and potential delays. The criteria for projects to be tendered need further clarification, for example on voltage, value and the explanation of what separability means. For example, 132kV projects in Scotland could be excluded as is not a transmission asset in England and Wales. A maximum number of new interfaces, with different parts of the existing transmission system should be set (we consider three may be reasonable). However, consideration needs to be given if auxiliary system interfaces should be included in this count. Furthermore some interfaces will be significantly more complex than others due to the specific electrical and physical design and layout of existing substations.

A potential issue in achieving an onshore competitively tendered regime is with regard to the grant, assignation or novation of statutory consents e.g. planning persimmons, section 37's or Development Consent Orders (in England and Wales). It is not currently evident under current UK planning legislation or the powers that vest in TO's under the 1989 act 9 (as amended), how these consents can be implemented when multiple parties become involved and may require a transfer of rights between them. This problem may give rise to a requirement to vary national legislation or, if not alleviated, present an unequal playing field for projects in different legislative areas.

Regarding obligations for the TO on information exchange we consider we fulfil these currently. However, these must also require the SO to provide information, as exchanged is necessary both ways. For example, constraint costs, system information and generator data. This may require reviewing the current provisions in the STC.

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

The SO should have a more directive role regarding interconnections, identifying the optimal solutions and reinforcing the overarching view of the system. This approach would make it more coherent with the proposed onshore approach, and will allow a more efficient and timely development of interconnections.

Regarding the remuneration of the assets, we are disappointed with the failure to bring interconnectors fully in to the same regulatory fold as onshore assets. This perpetuates the regulatory mismatch of certain assets, and in our opinion the cap and floor scheme does not guarantee a level playing field for all transmission owners. A proposal including tendering for interconnectors should be considered.

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

We agree with this proposal in general terms.

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

We agree with the proposal to maintain regulatory continuity of assets. The regulatory framework, especially in respect of their remuneration, incentives and obligations, should be as homogenous as possible across all the transmission activities.

If the objective is to guarantee a level playing field for all players and new entrants, we think that assets should be treated and remunerated in a similar way, adding the same incentives and obligations to its owners.

We consider this approach to be more equal than setting different remuneration schemes such as price reviews, auctions and price & caps for the same type of regulated assets. Besides, the incentives in place and timeline of the regulatory reviews that these assets are subject to also differ widely.

CHAPTER 4: Managing conflicts of interest

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

If competition is to be established for onshore Transmission, the option for incumbent TO's to compete outside their licence area will need to be established. To achieve this it is essential that there is sufficient business separation between the SO and its TO to provide confidence there is no conflict of interest. The 'synergies' (section 1.17) used to describe the relationship currently with the SO and their TO supports the view for clear separation, not against it, as the same synergies cannot be achieved with other TO's. For this to happen, we agree that transparency has to be increased in the SO and the TO potentially through a rearrangement of their licence or separate SO and TO licence being developed.

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

To mitigate possible conflicts of interest, we recognise separation and ring-fencing can be effective. The procedures proposed to support the new role for the SO under Electricity Market Reform (EMR) will support separation between the SO's competitive business and do not address the TO separation. However, we do not agree these have gone far enough in this case, specifically for the proposed responsibilities of the SO in respect of separation from their TO.

We consider that more details are needed, in relation to transparency, scrutiny of planning and requirements for ring-fencing of information and decision-making within NGET between its SO and TO. This could include compliance with a code of conduct that could define particular roles and responsibilities for Executive staff; a separate licence and physical separation. We recommend a wide-ranging and thorough consultation on any and all proposed licence modifications both in relation to NGET's licence and any modifications to the TOs' licences is undertaken.

Consideration could be given, to align with the RIIO principles of incentives and obligations that onshore TO have. For example, the SO could have an incentive (or penalty) linked to the outcome or number of conflicts of interests.

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

Based on our response to Question 10, we believe that it would provide the value for money, as the expected costs are low, and will add more transparency to the SO's role. Therefore, we think that independent scrutiny is appropriate