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Ofgem  
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Date: 10th July 2015  
Contact: Alan Kelly  
Tel: 0141 614 1958

Dear James,

### **Criteria for onshore transmission competitive tendering**

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 open letter on its criteria for onshore transmission competitive tendering.

UK regulatory arrangements and RIIO incentives in particular, are already driving innovation by TO's and delivering lower costs to customers. The existing onshore transmission system in GB is integrated, low cost and reliable and stands comparison with any other electricity transmission network, worldwide. It is our view that this has been achieved, primarily because it has been designed and operated as a single integrated network where the accountability for identification of economic solutions is vested in the owner. The owner, in his licence area, has to ensure the assets will be able to perform, and continue to perform, so as to ensure the appropriate transmission network performance and capability is achieved.

In recognition that the direction of change in the overall UK energy context now requires complex and increasingly variable and interactive power flows to meet changes in weather and economic generation mix, we are supportive of the development of National Grid's enhanced System Operator (SO) role. However, we are of the strong view that the expansion of parties involved in asset ownership in the onshore transmission system will erode the benefits secured for consumers by the present arrangements. We consider the potential benefits of introducing CATO's will be less than the costs of developing and implementing the regime.

A patchwork transmission system with multiple owners and interfaces will undermine the operability and co-ordination of activities on the transmission network in response to real time situations. It will also dilute responsibility and obscure accountability for ensuring the system will continue to perform as required and in an economic cost effective manner in the medium term. We do not believe dilution of ownership will in itself result in material savings for customers and consumers and could present a risk to the level of performance currently achieved by the GB transmission network.

We also have a concern over the assumption in the tender models that a tender package can be developed without increasing the duration of the end to end process for delivering complex projects.

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Furthermore, our experience in delivering many complex transmission infrastructure projects is that the design, consenting and delivery process are highly interdependent. Further, it is unclear how a CATO will be able to accommodate change being introduced during the lifecycle of the project in either the early or late tender models. For example, how will new generation connections impact on the original scope of the project and how will a CATO be able to accommodate and deliver additional new connections to their proposed assets where this is the most economic and efficient solution.

As a TO we have the flexibility and duty to achieve this within the network area under our control, ultimately delivering a more economic and efficient system for the consumer. In support of this point, the Jacobs report concludes (in section 4.1) that one of the two key elements fundamental before any project can be offered for competitive tender is a project scope that has a:

“ clear and precise definition of what is included and excluded from a project and project timing”

If they are to benefit consumers, CATO's will need to have the appetite, ability and capability to deliver coordinated solutions matching the performance, economy and flexibility that existing onshore TOs deliver.

We believe we have the responsibility, knowledge and experience to develop our transmission system, and will continue to contribute comprehensively to co-ordinated network planning to ensure the efficient, economic and co-ordinated development of the GB transmission system. Accordingly, we have worked extensively with National Grid and SHE Transmission to support the development of the Network Options Assessment Methodology, recently submitted to Ofgem.

As we have stated in our response to the draft conclusions, competitive tendering in the construction and delivery of major infrastructure is already fully embedded within our and project lifecycle, and is delivering savings for consumers. We do not believe dilution of ownership will in itself result in material savings for customers and consumers. If access to lower cost of capital is the key to savings then we have a view that this could be sought through other means and would welcome constructive dialogue on how that might be secured by a less disruptive approach.

We look forward to Ofgem providing clarity on these issues in their autumn consultation and will continue to highlight areas that need to be addressed to ensure best interests of GB consumers are met by these proposals. We have addressed the specific questions in your open letter in the attached appendix.

Kind regards



Alan Kelly

**Transmission Policy and Commercial Manager**

SP Energy Networks

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## **Appendix 1 Ofgem questions and SP responses**

### **1. What are your views on the analysis and conclusions in Jacobs' report?**

We do not consider this report has provided much clarity as to how the three criteria of new, separable and high value can be applied. However, this reflects the complexity of the challenge and highlights that as thinking develops from concept to reality the difficulty to develop robust rules will only increase.

The report's conclusion that new projects are inevitably going to involve interaction with existing assets is self-evident if a project is to extend or reinforce the existing transmission system. Their view (section 4.1.1) that a project scope must be tightly defined is also apparent but emphasises the limitations on flexibility that will result from introducing competition at an early stage, but reduces the opportunity for innovation in design the later in the project lifecycle the tender is issued. In both late and early tender models, opportunities are lost against the current regime where the incumbent TO takes full responsibility for the end to end process, mitigating risks and accommodating changes throughout the assets' life. We agree with Jacobs view (4.2.1) that the " additional time and cost that asset transfer will add to any project needs to be consider together with the impact on the TO's asset base and the expected benefits on any particular project of competition"

The proposal that asset ownership (section 4.2) provides a solution opens up the issue of how existing assets will be valued, compensation made and the consequence on shareholder uncertainty for future investment. Their solution that a percentage of 75/25% split of new/old assets in relation to project costs, is not justified by any quantifiable analysis and introduces a risk to the delivery of transmission infrastructure that Jacobs describes (section 4.3.1) as a;

"significant challenges around cost assessment, potential for gaming against the high value threshold, complexity around dealing with projects on the margins of any threshold value and the potential transaction costs of significant amounts of asset transfer."

We do not agree with the report that asserts (section 4.4.1) that electrical separability is not essential for a project to be considered for competitive tendering. One aspect of this is with regard to the safe and efficient operation, control and maintenance of an asset, its owner should be able to achieve independently of third parties. Notwithstanding that the conditions to make safe an asset may well involve third parties the ultimate ability to provide a safe system of work lies with the asset owner. Additional costs will therefore be inevitable and Jacobs identifies a limit of 5% of total project value as an upper limit to ensure competition remains beneficial to consumers.

With respect to high value we agree with Jacobs that project value should be evaluated over the life of the project. However, we would add that the project should consider the asset actual lifetime rather than its financial life. Typically, as an onshore TO we manage our assets beyond their financial life by robust maintenance and operational regimes, minimising replacement costs to the consumer. This needs to be considered in determining the benefits being realised by competitive tendering

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**2. What are your views on using £100m as the high value threshold? Should this be whole life or capex?**

As outlined in our response to Question 1 the value of the project should be considered over the whole life of the asset. The £100m value we understand is justified in terms of tender costs incurred in the offshore regime. We therefore have no further comment on this value other than to emphasise the introduction of tenders is another additional cost being placed on consumers that does not currently exist.

**3. What are your views on defining new and separable? Are our principles clear? In your view, do they appropriately capture projects where using competitive tendering would bring value to consumers? If not please explain and suggest how we can improve them.**

We agree with your view expressed in the open letter that tendering only new assets would “maintain regulatory continuity and clarity for existing owners, which is important for achieving long term stability and therefore value for consumers”.

We also agree with Jacobs’s view that it is difficult to identify projects for competitive tendering that involve only new assets.

These conclusions emphasises the potential benefits of competition are going to be difficult to achieve in an integrated transmission system, and will undermine achieving a co-ordinated system. The proposals to overcome this will result in simpler engineering projects being identified for tendering. There is a risk that this will become a driver in the design rather than development of the most economic and efficient solution. Furthermore this leaves the incumbent TOs with the complex higher cost projects to deliver.

**4. What are your views on the importance of electrical separability and electrical contiguity, including on the alternative approaches for considering electrical separability?**

We consider electrical separability to be essential should third party ownership of transmission assets be implemented as we explain in our response to question 1. Furthermore the development of suitable control and protection systems, access arrangements and other operational issues raises the risk of further costs to the consumers and a diminishment of a co-ordinated and efficient transmission system. For example, our RIIO-T1 outage programme which is the electrical equivalent of the west coast rail upgrade relies on the benefit of fully understanding the interactivity during times of depletion. If parts of the transmission system were in different ownership we risk losing the operational flexibility. To deliver the low carbon electricity system we will not be operating an intact system for the foreseeable future. Competition risks our ability to deliver the necessary upgrades to achieve the very goal Ofgem is trying to achieve.

We therefore do not agree with Jacobs or Ofgem’s assertions that electrical contiguity is not necessary to develop a discrete package of work. The consequence of eliminating this factor will result in a patchwork transmission system with multiple owners further undermining the operability and co-ordination of the system.

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**5. In thinking about how to apply the criteria, what should be taken into account when establishing different packages of works to address a given need?**

Applying the criteria must lead to the achievement of a co-ordinated, economic and efficient transmission system. Figure 1 in the open letter describes a reasonable process for selecting a package but does not present a basis for verifying if the chosen route achieves these fundamental objectives. Factors to be taken into account therefore should include a consideration of deliverability, operability, uncertainty and flexibility across the lifecycle of the asset. This should include a view as to how the assets may need to be developed to accommodate potential new generation or future modification or extension throughout their lives. How significant is the criticality of impacted circuits and will these be enhanced or undermined by third party ownership and what capability have the assets for supporting system security?

**6. What are your views on the three approaches we suggest for applying the criteria? Are there other options for applying the criteria that we should consider?**

We consider each of the three approaches only adds increasing layers of complexity to an assessment that does not necessarily contribute to determining whether a given solution will deliver an economic, co-ordinated efficient transmission system. Increasing complexity will only add uncertainty, delay and cost to the overall project.

**7. Are there any additional considerations that should be taken into account in relation to the new, separable and high value criteria?**

An assessment of where third party ownership might bring benefits should be included at an early stage. Based on a potential need a consideration of whether alternative designs, technology, deliverability will lead to consumer benefits could be conducted. The criteria must consider the full lifecycle of the assets to ensure that the definition results in a transmission system that is economic, efficient and co-ordinated and provides the optimum value to consumers not only in the construction phase but also in the operation, maintenance and modernisation phases.