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Date:
22nd July 2016

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Dear Joe

Extending competition in electricity transmission: criteria, pre-tender and conflict mitigation arrangements (“ECIT”)

SP Distribution plc, SP Manweb plc, and SP Transmission plc. (“the network companies”) are the “asset-owner companies” holding Scottish Power’s regulated assets and distribution and transmission licences. Scottish Power operates along divisional lines, and together, the activities of these companies fall within the Energy Networks division “SP Energy Networks” (SPEN). 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 proposals for extending competition in electricity transmission.

The current proposals should promote competition, however, to ensure effectiveness and to deliver long term benefits to the GB consumer the detail must be considered thoroughly to ensure that this new policy is effective. It is important to ensure tendering projects do not adversely impact Security of Supply and value for the consumer through extending delivery timescales.

Developing the Enduring Regime

The recent Networks Options Assessment (NOA)¹ report highlights that the timing for current planned, major infrastructure projects required to increase the capability of the onshore transmission and connect new large generation are required later than original timescales. Currently the proposed publication refers to nine potential SWW projects, however, only four are considered in the Investment recommendations section namely:

- Eastern Link Peterhead – Hawthorn Pit – E4DC
- New Beaulieu – Blackhillock 400kV double circuit – BBNO
- East Coast onshore 275kV upgrade – ECU2
- Hinkley Point – Seabank new double circuit – HSNO²

Only two of these four projects; the Hinkley Point – Seabank project and Eastern HVDC are given a proceed decision, and the Eastern HVDC is caveated with a minimum spend direction for this year. In addition to these, is Nugen’s proposed nuclear station in Moorside, Cumbria. If any SWW projects do come forward in the RIIO-T1 period, the likelihood is that they will be constructed in the RIIO-T2

¹ Network Options Assessment 1; UK electricity transmission; National Grid March 2016

² Tables 4.8 and 4.19

period. The proposals for establishing the procedures for the RIIO-T1 period may not be required as early as anticipated due to the changing generation background position impacting the timing of new infrastructure need.

Additionally, there are two key uncertainties that, if resolved, would facilitate the arrangements required to mitigate conflicts of interest in the enduring regime.

1. Who is to be responsible for developing the preliminary works for a late tender model in the RIIO-T2 period?
2. Will an independent System Operator be established?

It would be beneficial if these questions were answered in advance of developing more detailed procedures and should inform the direction of travel for the RIIO-T2 period that this consultation is providing.

Network Options Assessment not appropriate for ECIT in Transition Regime

In line with our view that the number of projects tendered in the transitional regime will be small, we do not think it is beneficial to include an assessment of eligibility for projects in the NOA reports in the RIIO-T1 period. We believe that the view of Ofgem following a Needs Case submission should be the only mechanism to make this assessment. Additionally, the identification for RIIO-T2 projects suitable for competition could be part of the price control submission process between TOs and Ofgem. An impact assessment of the potential projects agreed could then be conducted as proposed by the Select Committee report³.

Impact Assessments

At paragraph 1.14 of the consultation, Ofgem recognises the Energy and Climate Change Committee's recommendations of introducing impact assessments for project specific tendering decisions. However, at paragraph 2.5, Ofgem explains that it does not consider project specific impact assessments are efficient or appropriate before making a decision to run a tender. Ofgem's view is that this would lengthen the process and lead to uncertainty. Whilst this may lengthen the process, this delay is unlikely to be material and we agree with the Select Committee that projects specific impact assessment should "...focus efforts on the projects that deliver the biggest potential benefits..."⁴ and will benefit consumers overall.

In the absence of project specific impact assessments, we believe that the tender criterion should be expanded to include explicit consideration of delays tendering a project may impose on other infrastructure and generators connections in addition to impacts on other stakeholders e.g. local communities etc. We raised this issue in our response to the October 2015 consultation. At this stage it is not clear whether Ofgem has responded to the Select Committee's recommendation "...that Ofgem clarify, before the draft Bill receives its Second Reading, what exactly it will be doing to mitigate against the risk of delaying projects that are subject to tendering"⁵

³ House of Commons Energy and climate change Committee, Pre-legislative Scrutiny on the Government's draft legislation on Energy, May 2016

⁴ Ibid para 51

⁵ Ibid para 50

Generator Build

The inclusion of this option may be beneficial to consumers and improve the benefits of the enduring competitive regime. However, it is not clear whether ECIT is intended to allow a wider group of participants to do this or whether it is intended to allow generators to build assets that form a part of the main interconnected transmission system. Such a proposal could prove complex because in many cases the onshore asset would include wider works that impact other parts of the transmission network, including other generators seeking to connect. If it is intended to deal with this wider case, our view is that further consideration would be needed to deal with the interaction issues involved (ahead of the applicant becoming a licensee and so before they are subject to the normal rules).

As the focus in the current consultation is upon the Late Model during RIIO-T1, the answers we have provided to the specific questions raised in the consultation should be understood to be caveated with our view that the need for these arrangements may not be required as early as anticipated.

Please do not hesitate to contact me should you have any queries in relation to our response. We have addressed the questions posed in the above consultation in Appendix 1.

Yours sincerely



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Appendix 1: Answers to Specific Questions

Question 1: What are your views on our proposed arrangements for asset ownership and responsibilities? In particular can you provide examples of specific scenarios where it may be necessary for ownership transfer of existing physical assets to occur between network operators?

The transfer of non-physical assets will be required should a CATO require access to an existing physical asset of an incumbent TO; however, we do not agree that it must be a requirement to transfer ownership. Interface agreements should be sufficient to allow a CATO to access an incumbent TO's asset and should be tailored on a case by case basis. Only in particular circumstances where it is more appropriate for the CATO to hold the asset should this be transferred.

In relation to the decommissioning of existing assets, our view is that in general the existing owner should be responsible for decommissioning their own assets. Each project will vary in scope, complexity and timing. Therefore, we believe that decommissioning by third parties may present a risk to incumbent TOs assets. However, there may be situations where a CATO could deliver these works and could be included in the scope of an impact assessment. The party carrying out the decommissioning work should be selected based on the most cost effective option which has the least impact on the network.

Question 2: Do you agree with our proposed principles for packaging projects?

Whilst at a high level the principles for packaging sounds pragmatic, in practice this could lead to higher costs and project delays. If projects are split out into smaller sections, economies of scale are lost and project management strategies may vary between projects resulting in project delays and therefore a higher cost to the consumer such as increased constraint payments.

Paragraph 2.37 refers to the possible impacts on project delivery of splitting. However, the enduring operation of such fragmentation has a more significant impact and the decision to split projects must consider this aspect. The proposal in paragraph 2.39 to re-scope projects to allow it to meet the separable criterion will create a project which is less economic and efficient than the original scope. These elements are good examples to support the inclusion of project-specific impact assessments.

In addition, it becomes difficult for incumbent TOs and CATOS alike to predict potential future projects when moving away from the pre-defined criteria. This seems to be at odds with Ofgem's proposal to provide stakeholders with transparency around the potential pipeline to get the most from the competitive market.

Question 3: Do you consider the processes we have set out for determining which projects to tender are appropriate?

The recommendation to conduct an Impact Assessment for each potential tendered project directed in the Energy and Climate Change Committee (ECCC) report should be conducted in advance of any decision to recommend a project for competition. As the ECCC called for both written and oral evidence from various senior business representatives in relation to extending competition in transmission, it is our view that their report was well informed and should not be ignored.

Ofgem's decision to assess SWW projects proposed by TOs during RIIO-T1 is appropriate but we are concerned by the proposal that the SO will be required to assess projects though the NOA process in the RIIO-T1 period. This pre-empts any decision by Ofgem and potentially influences their views. This raises questions on conflicts of interests unnecessarily.

In RIIO-T2, it is proposed that tendered projects will principally be identified through the SO's NOA process. We agree that RIIO-T2 projects which are suitable for competitive tendering should be identified earlier in the project development process. We therefore consider the identification for RIIO-T2 projects suitable for competition should be part of the price control submission process between TOs and Ofgem. An impact assessment of the potential projects agreed could then be conducted. This would remove the requirement for the SO to make this assessment.

Paragraph 2.58 refers to options that the TOs have abandoned being considered further by the SO. It should be noted that the NOA process will recommend which options to proceed in any given year. Any options which do not proceed will be identified by the SO, not abandoned by the TO.

Question 4: Beyond the NOA and the connections process, what other routes should we be utilising to identify suitable projects for competition, eg for non-load projects?

As explained in our response to question 3, projects should be identified in the RIIO-T2 submission process including non-load projects.

Question 5: What do you consider should constitute 'early development works' for options ahead of their assessment in the NOA process, ie what works should be undertaken in order to ensure that the most appropriate tendered options are developed for submission at the initial tender checkpoint?

The development of a clear concept including needs case, optioneering, functional specification, single line diagrams; high-level costs and risks would be a minimum. However, it is clear that some options assessed in NOA will not have reached this level of maturity. Greater transparency is required in the definition of the stage of development of an option at which the SO assumes responsibility for its progression.

Question 6: What are your views on the suggested process for carrying out the pre-tender roles?

We agree with Ofgem's view that an incumbent TO's role in any late CATO build tender during RIIO-T1 will be to undertake the preliminary works for a project and carry out any necessary preparatory activities in advance of the tender. However, given the limited number of SWW projects that could now come forward for competition, the need for procedures and licence changes to establish these arrangements should be reconsidered and aligned to establish pre-tender arrangement for RIIO-T2.

As it is still not yet clear who will be responsible for delivering pre-tender works in RIIO-T2, the arrangements cannot yet be determined. The proposal for SO to carry out these works for the late tender model needs to be confirmed or other arrangements agreed.

Question 7: Regarding preliminary works and the tender specification:

(a) What are your views on the scope of the baseline tender specification?

The scope of works in the baseline tender specification does look reasonable.

(b) How likely is it that additional preliminary works will be required, and if so, what types of works are likely to be required?

Additional works may include crossing agreements and interaction with existing infrastructure for other systems. As a result, DNOs, railways and telecoms would also need to be considered. Land agreements may also be required to secure consents. Arrangements in Scotland, as has been highlighted in the consultation process previously

and reinforced in the EEEEC report, are different from England and Wales and this may affect the scope of tenders for different projects in the different regions.

(c) What are your views on:

(i) The role of bidders in identifying the need for further information / additional preliminary works (eg additional independent surveys) to inform robust bid assumptions?

Clarifications from bidders would be expected in the bidding process but if a clear scope and specification for the tender is achieved any additional works considered necessary would be the responsibility of the bidder to undertake

(ii) The most efficient process for enabling this?

Establishing a clear tender specification is essential with procedures to allow bidders to appeal to Ofgem for assessment of claims that insufficient information has been included in the tender.

Question 8: What are your views on the proposed arrangements for the data room and bidder clarifications?

These arrangements are only applicable to RIIO-T1 SWW projects and we do not anticipate that we shall be developing any SWW projects that will be eligible for competition. However should other TO's develop projects in this period, we agree the utilisation of a virtual 'data room' to compile information and documents which are relevant to the project, is reasonable.

Access to the project data room will need to be restricted and subject to confidentiality arrangements. Confidentiality agreements may be required on a case by case basis. When a bidder wishes to raise questions we agree that questions and answers should be readily available in a queries log in the data room. Not only will this ensure that bidders are treated equitably, it will avoid repetitive queries of the TO and avoid duplicative workload.

Question 9: What are your views on our proposals regarding the funding of preliminary works and tender support activities in RIIO-T1?

It is our view that an ex-ante allowance should be made available for TOs for assisting with activities associated with tendering a project that have not already been funded as pre-construction works under RIIO-T1. We agree that the cost of the preliminary works is borne by the successful CATO.

We agree that the transfer value of preliminary works, such as land rights or surveys, will be zero.

Question 10: Do you have any initial views on risk allocation across the preliminary works party and the CATO?

The principle that the CATO should hold the risk should prevail. The responsibility to bid or not against a particular specification lies with the bidder and if the specification is considered not sufficient then clarification should be sought or a bid withdrawn.

Question 11: Do you agree with our proposed requirements for incumbent TOs to mitigate potential conflicts of interest, where they are both bidding for and developing a project in RIIO-T1?

We agree with Ofgem's commitment to establish a level playing field for all bidders. However, the proposal to compete RIIO-T1 projects makes this difficult to achieve where the TO has developed the preliminary works. Therefore, as the portfolio of projects likely to be eligible for competition is

minimal, we believe these arrangements are not efficient. We have no issue with proposals for information, physical and financial separation, as they align to the established business separation obligations. We also support managerial separation; however, it is not our preference to establish separate legal entities. The incorporation of a separate company will create additional set up and annual costs and may also have implications for payroll and contracts for employees with little benefit in return. We also question the benefit to consumers of having staff transfer processes which may bring inefficiencies as a result of having two distinct teams given the likely low volume of activity. We believe the overall requirements should be a mirror of those already established in TO licences.

The preparation of a methodology covering the steps the TO has taken in the three overarching areas of conduct, business separation and scrutiny would provide other companies with reassurance that the bidding TO has clear business separation provisions in place. Therefore we would support this measure. We would however question the benefit of having both a pre-tender compliance report and a post-tender compliance report. Our proposal would be to include a post-tender report only as this is reporting on *actual* performance. The preparation of a “looking forward” tender report is of little value as it will only say what a company expects to happen and not what it actually carried out to mitigate any conflicts of interest. We believe that it would be pragmatic to include an additional section within the current business separation reports to address all bidding team business separation arrangements. This would negate the requirement for an additional annual report.

Question 12: Is internal scrutiny of the arrangements the TO has in place to mitigate conflicts of interest sufficient, or would there be significant additional value in having an independent party scrutinise and audit the TO’s arrangements?

As explained in our response to question 11, Scottish TOs currently have established business separation provisions in place. These are currently validated by annual reports from the appointed Compliance Officer and are not subject to any additional external audit. This is deemed sufficient under existing business separation arrangements. We believe any audit would generate an unnecessary additional cost and it would be more efficient to extend the Compliance Officer’s role and report to encompass these new arrangements and the consultation does not outline the proposed frequency of such an audit. Our Compliance Officer reports annually and we believe it would be a natural extension to their role to cover preliminary/bidding works arrangements.

A TO bidding should operate from a separate part of premises with restricted access between locations. However, from a TO perspective, the requirement to implement Business Separation for ‘preliminary works’ and ‘bidding party’ team will create additional costs that could be deemed an inefficient use of resources.

Question 13: Do you agree with our proposal to manage conflicts for other bidders?

The proposals for other bidders should replicate the proposals for TOs where appropriate. Those proposed for the other bidders appears to be at a significantly lower bar than for TOs. As such, we wonder how this can create equitable conditions for competition. For example, there are no blocks on staff transfers proposed for bidders.

We agree that a bidder should be required to sign a confidentiality agreement to gain access to confidential information. With respect to the ‘conflicts of interest declaration’, we would suggest that Ofgem also request the TO to make a declaration as to which parties have advantageous information that may give rise to conflicts of interest, to incentivise the bidder to declare.

Unless separation obligations are consistent across the parties there is a risk that the regime stifles competition by making it uneconomic for TOs to participate, especially given the likely low volume of projects that will meet the criteria. If the early CATO model were followed this could negate the need for all these additional obligations and save costs which will ultimately benefit the consumer.

We reiterate, the role of the SO must be clarified and steps taken to ensure there are robust separation arrangements built into their organisation and processes.