

Inveralmond House  
200 Dunkeld Road  
Perth PH1 3AQ  
email: leticia.pelizan@sse.com

Joe Baddeley  
Transmission Competition Policy  
Ofgem  
9 Millbank  
London  
SW1P 3GE

21 July 2016

Dear Joe,

## **Extending competition in electricity transmission: criteria, pre-tender and conflict mitigation arrangements**

Scottish Hydro Electric Transmission plc (SHE Transmission) welcomes the opportunity to respond to Ofgem's latest consultation and the further proposals for development of the arrangements necessary for extending competition in electricity transmission (ECIT). In particular we appreciate the greater clarity in the definitions around the criteria and further information on the pre-tender arrangements. We also welcome the proposals around conflict mitigation, which are a good starting point for Transmission Owners (TOs) to develop appropriate process and procedures to alleviate concerns in this area.

Notwithstanding this, we continue to have some concern over the development of a competitive regime, the arrangements and roles to guarantee a level playing field, the assessment of benefits and the timetable for its introduction. Our main concerns in these areas remain and are summarised below. They are discussed further in the Appendices to this letter.

### **Criteria for competition**

High value threshold: In our view, as we have emphasized in our response to a previous consultation<sup>1</sup>, the different high value threshold in England & Wales and Scotland for competitive tendering of onshore transmission assets during RIIO-T1, is clearly discriminatory. It is disappointing therefore that Ofgem has decided that such a threshold is appropriate. We would once again urge Ofgem to carefully reconsider the consequences of its decision in this area.

### **Pre-tender arrangements**

The roles of the SO and TO in the Competitive Process: We note that following the conclusion of the ITPR project, National Grid Electricity Transmission's (NGET's) System Operator (SO) function has been given additional responsibilities in relation to system need identification, system design, assessment of investment options and overall co-ordination of the GB National Electricity Transmission System (NETS). It also has an advisory role to Ofgem regarding the development of preliminary works and tender specification for the development of competition. The latter roles and responsibility are continuing to evolve as the ECIT project develops and we have some concerns with the present proposals as follows:

---

<sup>1</sup> SHE Transmission response to the "Extending competition in electricity transmission: arrangements to introduce onshore tender" consultation, sent in 8 January 2016.

- System need identification: the Network Options Assessment (NOA) process is the principal route to identify the system needs and the suitability of projects for tendering. We are concerned about the submission by the TOs to the SO of a breakdown of the project costs, and the proposed SO role in scrutinising these costs. Whilst some 'ring fencing' of this confidential information has been put in place, we still do not believe that it is appropriate to require the TOs to share detailed costs with a GB SO whilst it is still closely affiliated to the England and Wales TO. In our detailed response we propose alternatives to address this situation.
- System Design: As previously stated<sup>2</sup>, in our view, the process proposed for identifying options, carrying out early developments works and the initial solution design blurs the statutory obligations of the SO and TOs. We do not believe it is efficient to have a regime where both the SO and TOs (and CATOs in the future) would be carrying out these activities. In our view, the SO role should be to identify system need, with the existing TOs maintaining responsibility for system design in their geographic areas.
- Pre-tender arrangements (from RIIO-T2): we agree that the SO assuming the pre-tender activities is an effective way to mitigate conflicts of interest that could arise when a TO undertakes these activities and also competes for the construction of a project within its licenced area. However, we should be aware that transferring these responsibilities from a TO to the SO, whilst it is still closely affiliated to the England & Wales TO, does not eliminate the conflict of interest within National Grid, in its SO and TO functions. We believe that an Independent System Operator (ISO) is the best option to guarantee that the expertise gained in the pre-tender arrangements would not favour any competitor.

As we have previously indicated, in our view, in the medium/long-term, the best solution to ensure that there is a level playing field for all participants is to migrate to an ISO based operational model. Meanwhile, for RIIO-T1, we expect at least that the SO put in place strong business separation measures to mitigate the conflict of interest associated with the competitive process, together with the implementation of alternative arrangements we are suggesting throughout this and previous responses.

## Mitigating conflicts of interest

Conflict of interest from the TO's role: We welcome the proposals around conflict mitigation, which are a good starting point for TOs to develop appropriate process and procedures to alleviate concerns in this area. SHE Transmission, as part of SSE plc and a Vertically Integrated Undertaking, is already operating a successful Business Separation Policy. Therefore we believe we have enough experience and expertise to put in place the necessary arrangements to separate the TO bidding party from the TO preliminary work team.

Conflict of interest from the SO's role: As we mentioned above, we believe that many potential conflicts of interest could emerge from the enhanced role of the SO and the fact that it is closely affiliated to the England and Wales TO. We note that Ofgem is aware of that and it is working with DECC and NGET to address this issue. We welcome this essential debate and believe that its significant impact on the GB transmission system justifies the participation of all the stakeholders in the discussion. We believe an ISO is the only option that will facilitate a fully competitive model in electricity transmission, assuring that not just

---

<sup>2</sup> Ibid.

the pre-tender arrangements but also the day-to-day operations and the long-term priorities are aligned with the best interest of customers.

### **ECIT timescales and RIIO-T1 Projects**

We appreciate how the ECIT project has been conducted so far, allowing our participation through several working groups, in a collaborative environment, and considering the inputs, concerns and suggestions of the various stakeholders. Nevertheless, we remain concerned about the feasibility of the proposed timetable. There are seven major consultations planned for the next 12 months. We believe that the detailed character of these future consultations will require longer workgroup sessions, significant internal resource dedication from all participants, and extended consultation times.

Given the limited number of RIIO-T1 projects likely to be available for competition, we would suggest that Ofgem, with the industry, reviews the programme for the development of competition. We believe the focus should be on ensuring that both the early and late CATO models are available for the start of RIIO-T2.

### **Updated Regulatory Impact Assessment (RIA)**

Whilst we appreciate the elaboration of an updated and improved version of the RIA, we believe that it requires further refinement. We continue to have concerns, previously shared with Ofgem, about the robustness of the RIA in regards the costs-benefit analysis and its justifications, and the significant differences (and risks) between the OFTO regime and that proposed for onshore competition.

Furthermore, we have now identified other areas where we believe there is room for improvement. These are detailed in Appendix 3 - Critique of updated Impact Assessment. We believe further revisions are required at this point of the regulatory development in order to help to manage the risks, develop a reliable and workable regime, and finally to deliver the expected benefits of introducing competition in onshore electricity transmission to the customers.

### **Conclusions**

SHE Transmission remains cautiously supportive of the concept of extending competition to onshore transmission assets and welcomes the further information and clarity provided in this consultation. We are happy to discuss the above and our extended response in the appendices further, and look forward to working with all interested parties as the competitive delivery framework is developed.

Yours sincerely,

**Leticia Pelizan**  
**Senior Regulation Analyst**

### **Appendices**

- 1. Detailed response**
- 2. Response to consultation questions**
- 3. Critique of updated Impact Assessment**

## Appendix 1: Detailed response

### *Thresholds for competitive delivery*

We have previously expressed our concern with the different high value threshold in England & Wales and Scotland for competitive tendering of onshore transmission assets during RIIO-T1. In our view, it is clearly discriminatory that SWW projects in Scotland valued between £100 and £500 million could be subject to competition, whereas an identical project in England and Wales would not be. It is disappointing therefore that Ofgem has decided that such a threshold is appropriate, arguing, among other things, that this difference is not discriminatory as, in the TOs' RIIO-T1 business plans, "these thresholds were proposed by the TOs, and reflect the business needs and risk appetite of those companies". We have previously made it clear that those values were proposed by the TOs as thresholds for SWW projects in the context of RIIO-T1 and they were not offered as a basis for determining the value of projects that should be subject to competitive delivery. As thresholds for SWW, they reflect timing and costs uncertainties of large network investments and provide flexibility to manage these risks, ensuring value for money for consumers by adjusting the project to the most appropriate time. We never intended that these thresholds be considered as the TO's proposal as thresholds for the introduction of competition.

We recognise that it is only SWW projects that will be identified for competitive delivery prior to RIIO-T2. However, unless the high value threshold is set at the same monetary value across GB, then the competitive process will be discriminatory: Scottish TOs will not be allowed to compete for projects in England & Wales valued between £100 and £500 million, while the England & Wales TO could compete for these projects in Scotland. We would once again urge Ofgem to carefully reconsider the consequences of its decision in this area.

### *The SO and TO roles in system need identification (project identification)*

Ofgem notes that the SO's NOA process will be the principal route to identify the system need and the suitability of projects for tendering. We are aware that the SO is reviewing the NOA report methodology, and expects to include in its process an assessment of the TOs' options against the competition criteria. It could require the submission by the TOs to the SO of a breakdown of the project costs, and the scrutiny of these costs by the SO. This is to give to the SO enough data to allow the development of a robust optioneering and least worst regrets analysis, as well an assessment of the TOs' options against the competition "high value" criteria, and we welcome the idea of a stronger assessment of the options and costs submitted by the TOs. Nevertheless, as we mentioned in a letter sent to NGET (copied to Ofgem)<sup>3</sup>, we are worried about possible negative effects that this SO role could bring to the competitive process. Despite the fact that the review of the NOA process is not included in the scope of this consultation, we think it impacts directly on the roles and activities expected of TOs and SOs in the projects identification phase, and therefore should be considered in the discussion of the ECIT framework.

Although the NGET licence includes measures to ensure the protection of "relevant system planning information" (RSPI) and NGET has been working to refine the RSPI arrangements, we still have concerns. From a competitive perspective, we do not believe that it is appropriate to require the TOs to share detailed costs with a GB SO while it is still closely affiliated to the England & Wales TO. Considering that all TOs are potential competitors, sharing TOs' breakdown costs with a SO which is currently in the same group

---

<sup>3</sup> Letter in response to "Consultation on National Grid's Network Options Assessment (NOA) Report methodology – NOA2 Methodology Draft". Copy sent to Ofgem in 01 July 2016 via e-mail.

that own the England & Wales TO could lead to the potential for an anti-competitive situation to arise. Such a situation could undermine the benefits expected from the introduction of competition in transmission.

Furthermore, we would question whether the SO currently has the expertise needed to assess the TOs' project costs, as it does not have expertise in detailed design, procurement activities and asset build.

We believe that the final goals (i.e. the evaluation of the options against the high-value criteria and an assessment of the reasonableness of the costs) should be achieved by other methods rather than through the TOs submitting detailed costs directly to the current SO.

For RIIO-T1, for the NOA preliminary cost assessment, we propose Ofgem develops a "transmission schedule of rates" to be used by all parties for option costings that go into the Initial Tender Checkpoint (ITC) and the NOA process. Such a scheme would include all the estimated costs for developing and construction of a transmission network project, considering different technologies and locations. We discuss some key advantages of such an approach in our response to question 5 of this consultation.

We note that the SO is currently considering employing a consultancy firm to carry out detailed scrutiny of TO costs. Unless the proposed "transmission schedule of rates" is developed, we believe this is essential until strong business separation between SO and TO functions are put in place. A high-level output of such assessment could then be provided to both the SO and Ofgem without compromising competition. Any third party consultancy would be required to enter into a suitable Non-Disclosure Agreement with the TOs.

In the long term, e.g. from RIIO-T2, we believe that an entirely independent system operator is the only option that accommodates a fully competitive model, assuring that not just the pre-tender arrangements but also the day-to-day operations and the long-term priorities are aligned with the best interest of customers.

### ***The SO and TO roles in system design (identification of options, early development works and initial solution design) in RIIO-T2***

Ofgem sees a key role for the existing TOs in identifying and considering options on their networks to address system need identified by the SO (TO-led options and early development works). In conjunction (parallel), the SO is expected to identify options not identified by the TO (SO-led options and early development works). As we referred in our response to the previous consultation<sup>4</sup>, in our view, the process proposed for project identification and pre-tender activities for medium and longer term projects blurs the statutory obligations of the SO and TOs. We do not believe it is efficient to have a regime where both the SO and TO would be identifying options to address system need, including Security and Quality of Supply Standard (SQSS) compliance, and then undertake early development of those options. The lack of clarity around system design responsibilities and associated liabilities will lead to inefficiencies and duplication of work, as both SO and TO should maintain specialized teams and processes to system design, and could increase the risk to security of supply. This cannot be in the best interests of consumers. Ofgem must ensure that there is clarity on what obligations are assigned to which party and satisfy itself that any risk to security of supply is fully addressed.

---

<sup>4</sup> SHE Transmission response to the "Extending competition in electricity transmission: arrangements to introduce onshore tender" consultation, sent in 8 January 2016.

In our view the SO role should be to identify system needs (through the NOA), with the existing TOs maintaining responsibility for system design (options' identification, early development works and initial solution design) in their geographic areas, submitting the case to the ITC. The only alternative is for a fully Independent System Operator (ISO) to be set up. If the latter is the preferred model, the ISO would take full responsibility, and the respective obligations, for all system design. In this scenario, until the ISO is in place, it will be essential that responsibility for system design is retained by one body, the TO, in the three geographic areas.

Our preference is for the existing TOs to continue with this role, certainly in the short to medium term. The existing process works well, and is the result of many years of joint working between the SO and TOs. If, in the longer term, the decision is made to establish an ISO, then transitional arrangements will be essential as the new body starts to take over the role of the existing TOs in options identification and early development works.

#### *Mitigating conflict of interest from the TO role*

We welcome the proposals around conflict mitigation, which are a good starting point for TOs to develop appropriate process and procedures to alleviate concerns in this area.

We agree that conflict mitigation measures are necessary when a TO is bidding, in its licensed area, for a project which preliminary works were developed by the same TO. We also agree that these measures should be a combination of obligations of conduct, business separation and scrutiny measures. In our view, the proposed scheme of elaborating a specific conflict mitigation methodology before each project and monitoring it throughout with compliance reports will assure that the right measures are in place.

SHE Transmission, as part of SSE plc and a Vertically Integrated Undertaking, is already operating a successful Business Separation Policy where restrictions and governance policies are applied within IT systems and physical locations, ensuring confidentiality of data and no cross subsidies. Therefore we believe we have enough experience and expertise to put in place the necessary arrangements to separate the TO bidding party from the TO preliminary work team.

We expect to set up a "TO bidding party" when we decide to tender for the delivery of a projects. Although we agree that robust arrangements should be put in place, they should be flexible and allow an agile deployment to accommodate the temporary nature of the TO bidding party.

We offer more details about our view on conflict mitigation arrangements in our responses to questions 11 to 13.

#### *Mitigating conflict of interest from the SO role*

We note that Ofgem is aware that the SO's proposed role in the competitive process could give rise to an unfair advantage for NGET, and that Ofgem is working with DECC and NGET to address this issue. We welcome this essential debate and believe that its significant impact on the GB transmission system justifies the participation of all the stakeholders in the discussion.

As we detailed in the section entitled "The roles of the SO and TO on the Competitive Process" in this response, we believe that many potential conflicts of interest could emerge from the fact that the current SO is closely affiliated to the England & Wales TO. It is of particular concern considering that National Grid's

transmission network system operator (SO) function will be given additional responsibilities in the process of the transmission network expansion and in particular in the competitive process.

In our view, the best solution to mitigate these conflicts of interest is the establishment of an ISO. Meanwhile, for RIIO-T1, we expect at least that the SO puts in place stronger business separation measures than the ones currently in place. That will minimise potential conflicts of interest and thus give the public and the market confidence that the SO's objective remains to operate a safe, stable and secure network. Although we recognise that there are certain costs associated with any such undertaking, we are of the opinion that the benefits outweigh the potential costs. The industry is accustomed to separation between the SO and TOs in Scotland, it is thus our view that similar arrangements could, with minimal disruption and little impact on industry synergies, be applied in England and Wales. As this is not a proposed topic for discussion in the current consultation, we would refer Ofgem to our May 2016 papers submitted to DECC (copied to Ofgem) with our preliminary views on the matter.

### *Conclusions*

SHE Transmission remains cautiously supportive of the concept of extending competition to onshore transmission assets and welcomes the further information and clarity provided in this consultation. We are keen to continue our involvement in the industry working groups that are developing the competitive regime.

Nevertheless, we continue to have concerns about Ofgem's proposal to set the high value threshold across GB to £100 million during RIIO-T1 when only SWW projects are able to be competitively tendered. We are very firmly of the view that this is discriminatory and challengeable if Ofgem's decision following this consultation remains the same. We continue to reserve our position with regard to this.

We are also concerned about the enhanced role of the SO in the competitive process, that in our view will blur the statutory obligations between the SO and TOs and bring out many potential conflicts of interest. In our view, the SO role should be to identify system need, with the existing TOs maintaining responsibility for system design in their geographic areas. The only alternative is for a fully independent system operator to be set up. If the latter is the preferred model, the ISO would take full responsibility, and the respective obligations, for all system design. In this scenario, until the ISO is in place, it will be essential that responsibility for system design is retained by one body, the TO, in the three geographic areas. We also expect that the SO put in place strong business separation measures to mitigate the conflict of interest associated with the competitive process, together with the implementation of other alternative arrangements we suggested.

Finally, we remain concerned about the feasibility of the proposed timetable and believe a focus on delivering competition in RIIO-T2 would ensure the best use of time and resource from across the industry.

## Appendix 2: SHE Transmission response to consultation questions

### Criteria for competition - Responses to questions 1 – 5

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?*

We believe that the existing physical asset access and operational agreements should rely on the existing industry codes and standard commercial agreements, with little or no space for tailor-made arrangements. It will ensure a robust and reliable system from an operational perspective, and avoid potential conflicts about liabilities.

Regarding the potential for ancillary works to be undertaken by a DNO to allow the transmission development, beyond the RIIO-T1 projects, we can not see any reason why a DNO would recover the costs of these works from the TO instead of from the CATO. We believe that the tender specification should identify these works and associated costs wherever possible, allowing the bidders to consider them in their offers.

We agree with the observation in 2.26 that instances where ownership transfer of physical assets may be required are likely to be few and limited. Examples might include the transfer of isolating and earthing devices and short sections of busbar in order to facilitate safe construction, for technical reasons and for consistency with Connection and Use of System Code principles of ownership. In all cases, other options should be considered and assessed against the transfer of physical assets option.

2. *Do you agree with our proposed principles for packaging projects?*

Regarding the packaging principles, in the “What is a ‘project’?” section, we would suggest the inclusion of a definition on what is “a common need” that will link a set of works that will constitute a project.

Furthermore, we believe that an important principle should apply when “packaging”, i.e. the smallest permissible package of works is that which delivers system benefits in its own right. That is to say that any package of works could only be valid as a standalone package for tendering if it does not rely on any other works for the realisation of any system benefit.

With that principle in mind, we particularly note that in 2.36 it is clear that bundling would only apply to projects already above the high-value threshold, i.e. those projects would themselves already have stand-alone value before being bundled.

The above principle is especially important with regard to splitting, i.e. no project product of splitting should be reliant on completion of any other for its value to the system.

To the extent that different skills and specialist experience is required, the onus should be on the supply chain to arrive at its own competitive arrangements for management of interface risk in order to minimise the risk of asset stranding.



It is valid to consider splitting the tendering of a project according to its phases, but only where each successive phase will deliver system benefits in its own right.

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

Our main concerns in the process proposed are related to new roles assigned to the SO and TOs, and which are detailed in the introduction and in the Appendix 1 to this response.

We also would like to highlight that the process for decision and tendering will add upwards of 9 to 18 months in the timeline of RIIO-T1 projects and between 8 and 14 months to in RIIO-T2 projects<sup>5</sup>. This is an important factor to consider, especially for RIIO-T1 projects, when assessing the benefits of putting a project out to competitive delivery.

For RIIO-T1 projects, we agree that the factors identified in 2.48 are particularly relevant to the consideration of a decision to tender RIIO-T1 SWW projects. However, the same factors are equally relevant to the decision in respect of RIIO-T2 projects and therefore the process must include an impact assessment for each project, quantifying the value of the benefit to customers for each project and assessing the risks, and including the findings/calculations in the consultation material. We believe that the high costs, the complexity and the impact for the future customers of the transmission projects justify an individualised impact assessment. In this way, we agree with the recent House of Commons Energy and Climate Change Committee recommendation to introduce project-specific impact assessments ‘to ensure that efforts are concentrated on projects with the biggest potential benefits’<sup>6</sup>.

4. *Beyond the NOA and the connections process, what other routes should we be utilising to identify suitable projects for competition, e.g. for non-load projects?*

We believe that the main routes have been identified in the consultation document. SHE Transmission does not foresee non-load projects in the north of Scotland that would satisfy the criteria for competitive treatment in the RIIO-T1 and T2 periods. We do, however, recognise the potential for TO-led options as described in 2.62 which highlights a more fundamental issue of the allocation of responsibility for option identification and planning between enhanced SO and multiple TOs.

SHE Transmission agrees with the principle of common obligations for all transmission owner licensees, i.e. new entrants should not be excused the duties of a GB transmission licensee. Specifically, in 2.62 it is recognised that future CATOs as well as existing TOs, must have a role in identifying reinforcement and upgrade options. (To the extent that all licensed transmission owners would be under the same obligation to identify reinforcement options in their “licensed area” then this should also include OFTOs.)

However, an increasing number of transmission licensees may lead to an increasing number of reinforcement option proposals, some of which may be candidates for competition and therefore potential

---

<sup>5</sup> RIIO-T1 estimation: 4-8 months INC assessment + 1-4 months consultation + 3-6 FTC Final Tender Checkpoint stage + 4-6 months (our estimation) to tendering process - 3-6 months current NC assessment.  
RIIO-T2 estimation: 4-8 ITC assessment and consultation + 3-6 FTC stage + 4-6 months (our estimation) to tendering process - 3-6 months current NC assessment.

<sup>6</sup> Point 51, page 26 - House of Commons Energy and Climate Change Committee (2016), pre-legislative scrutiny of the Government’s draft legislation on energy.

ownership by yet another new party; also with obligations for identification of future options – and so on. There is a clear question concerning the long-term sustainability of such arrangements and, in the meantime, a more fundamental question of how local reinforcement proposals by the increasing number of TOs are co-ordinated by the enhanced SO with its whole system responsibilities. The consequence of this is for either an ISO assuming these obligation for the whole GB system, or a thin SO coordinating it at a high level with the existing TOs responsible for the system design in their respective areas.

5. *What do you consider should constitute “early development works” for options ahead of their assessment in the NOA process, i.e. 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 question refers to “early development works for options ahead of their assessment in the NOA process”, i.e. ahead of the NOA option assessment process. However, the first box of Figure 6 of the consultation document implies project identification through the NOA (and other processes) before early development works are undertaken. Given the rest of the question, we read it as what works should be undertaken as “early development works” to support and accompany the “need” elements of the information for an ITC.

On that basis we agree with the expectations expressed in 2.60 that early development works should not involve field analysis to any extent greater than visual site inspection.

To the extent that early development works were undertaken by a TO as indicated in the first box of Figure 6, we would therefore expect the works for any one option to include:

- Desktop environmental constraints mapping
- Schedule of land ownership
- Definition of the capacity to be provided
- Technology choices
- Preliminary siting and routing
- Budget cost
- Outline programme

We propose Ofgem develops a “transmission schedule of rates” to be used by all parties for option costings that go into the ITC and the NOA process. Such scheme would include all the estimated costs for developing and construction of a transmission network project, considering different technologies and locations. Some key advantages of such an approach are described below:

- 2.62 and 2.63 note the desirability of being able to compare and challenge TO-led options with those of the SO. However, those parties will all have different approaches to the preparation of budget costs and, in any case, the most relevant costing will be that of the successful bidder and not necessarily that of the initial identifying party. A common schedule of rates would therefore facilitate valid comparison of options.
- This approach would avoid potential budget costs manipulation, either below or above the threshold.
- Ofgem will have sight of actual costs in the course of SWW Project Assessments, OFTO and CATO bids, and regulatory funding requests. This would enable the best and most up-to-date schedule of

rates to be produced and maintained regularly by Ofgem, thereby ensuring that option costs for budget purposes are as reflective as possible of reality.

- This proposal prevents parties from revealing the breakdown of their costs, preserving the confidential character of this information from potential competitors.

## **Criteria for competition – Additional comments**

Threshold review: we agree with the need to review periodically the high-value threshold considered for tendering. Nevertheless, we believe this revision should be aligned with the price control periods, i.e., defined ex-ante and be fixed over the whole period. It would help to guarantee that TOs allocate the right resources to the development of “non-competed” and “in competition” projects, to avoid pre-funding activities that throughout the price control period could be developed through competitive tendering, and to give a medium-term predictability to all stakeholders.

## **Pre-tender arrangements - Responses to questions 6 – 10**

### *6. What are your views on the suggested process for carrying out the pre-tender roles?*

We assume that this question relates to the proposals for SWW projects under RIIO-T1, and to preliminary works (initial design, consenting process and undertaken studies/surveys) and tender specification. We note that where Ofgem decide to tender a RIIO-T1 SWW project under late CATO Build, the TO will be responsible for the preliminary works and preparatory activities required ahead of a tender. This would seem to be the most logical route to take given that, in RIIO-T1, the incumbent TOs will have already started such works and received funding for them. Any other approach would not be efficient and there is also the potential that confusion would arise amongst stakeholders and consultees if there were to be a change in the party responsible for preliminary works. Additionally, there could be contractual and warranty implications arising if another party was to take over these works from the TO in “mid stream”, where a TO has engaged contractors and consultants to provide design and other services to carry out the preliminary works.

We should advise that in our experience, the process of carrying out preliminary works to enable a project to reach a stage whereby it could be suitable for tender, as envisaged by Ofgem, could take up to 3 years. This timescale allows for the provision of all relevant information required to ensure risk mitigation and provision of a clear scope for potential bidders to quote against.

The reason for this is that, generally, SWW projects will fall within Schedule 1 or 2 of the Environmental Impact Assessment Regulations (“EIA Regs”) and the timescale suggested takes account of the requirement to gather survey information (the timescales for this can be up to 1 year in order to get a full year’s data for bird and other species) in order to inform that environmental assessment, and the preparation of it prior to submission of an application for consent under s37 of the Electricity Act 1989 (the 1989 Act) and determination of that application.

7. *Regarding preliminary works and the tender specifications:*

a) *What are your views on the scope of the baseline tender specification.*

We note the contents of the baseline tender specification and the associated preliminary works that have been identified by TNEI/Poyry in their report. Generally, what is listed reflects our experience as TO of works typically undertaken ahead of procurement and construction of a transmission project. However there are some areas which are worthy of further mention:

- Often, interaction with adjacent systems or infrastructure needs to be considered. These can range from crossing agreements with railways, works required on a DNO network for diversions etc. These would need to be identified prior to tender and where possible arrangements put in place in order to drive certainty on costings.
- As consents are one of the deliverables at preliminary works stage then the preliminary works have to be directed to achieve a particular level of detail so that these consents can be secured or at least be in the process of being secured at the time of tender.
- It is important to understand that there are key differences between the regime for securing planning consent under the Town and Country Planning Acts (under which substations would be consented) and s37 consent under the 1989 Act for overhead lines.

Under the Town and Country planning regime, an application for planning consent in principle can be made for development on a specific area of ground. The scope of development is identified, but is not detailed and a local authority can give consent in principle to that development, although final consent will be subject to full design, assessment etc and often the scale of development may require full assessment under the EIA Regs. Therefore if such an approach is pursued, then studies such as noise assessments will not be carried out until the full specification of development is available, though base line assessments can be provided at the time of application for consent in principle.

However, applications for s37 consent under the Electricity Act 1989 cannot be secured on an “in principle” basis. Nor can consent be granted for a route corridor. The final route alignment has to be identified (to which is often applied a pre-determined limit of deviation, developed having regard to environmental constraints) and studies required in order to determine that alignment will be required in order to ensure that the project can be assessed under the EIA Regs and that assessment completed and submitted in support of the s37 application, supported by details of construction techniques, access and logistics, traffic management. The s37 process requires the design to be sufficiently mature in order to drive certainty at the consenting stage, and the baseline tender specification has to reflect this.

- We have noted that documents relating to land rights acquisition have not been listed and we would suggest that in order for any bidder to have clarity, information relative to rights secured, or if those are not as yet finalised, then a strategy for how these are to be secured should at least be detailed in order to allow tenders to assess risk to be allocated. In addition where consents or land agreement are not finalised, then there has to be consideration of the roles that the TO and any successful CATO will have in delivering those. In particular, if a consent is the subject of a formal inquiry, there would have to be discussion as to roles and responsibilities in handling these, as well as which party is liable to discharge conditions associated with any consents or agreements.

- Vessel availability is not something that a TO would be assessing at the time of preliminary works. That would be down to any bidder to assess and determine their programme for delivery based on availability.
- We note that whilst care has been taken to set out the baseline tender specification, there has been no discussion on the contractual basis upon which tenders will be assessed. There are various forms of contract, such as NEC, Fiddic etc, but at some stage there will need to be certainty in order that returns in accordance with the relevant contract suite can be provided by bidders. This will also be essential as different forms of contract may result in different pricing and risk weighting structures so there has to be certainty from the outset.
- We would also highlight the importance to include, in the tender specification package, an instruction of tendering, the main document that should be developed by the contracting party (Ofgem) defining the tendering conditions in detail. It would be also necessary that Ofgem includes clear instructions about offer presentation in order to facilitate the comparison between bidders' proposals, and the criteria to assess the offers.

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

As we have identified above, we do not think that the scope of preliminary works is sufficiently wide enough to allow for the studies that will be needed in order to derive a detailed overhead line route for consenting. Allowance needs to be given for the TO to carry out such design works as it determines are required to deliver that output.

Additionally, in subsea cable connections further information such as a burial assessment would be required for a marine survey.

We are of the view that a TO will carry out the preliminary works that it determines are necessary for it to be able to develop a project which is capable of being consented and constructed. However, there is a chance that any bidder might take the view that additional preliminary works are needed and the TO may not necessarily share that view. At that stage, we suggest that Ofgem's role in at the Final Tender Checkpoint will be critical in confirming that the TO has provided sufficient information, or indeed identify where it thinks that there may be gaps and give the TO an opportunity to rectify that.

Additional preliminary works might also have to encompass the running of and management of any formal process associated with land acquisition via Compulsory Purchase or securing consents through Public Inquiry.

Considering the diversity, timescale and complexity of the large network projects, it is possible that the TO/SO developing the preliminary works could identify a need for additional preliminary works. The pre-tender process should therefore consider a route to address these potential situations.

*c) What are your views on:*

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

As outlined above, Ofgem's role in assessing that the project is at a stage for tender should give prospective bidders comfort that the information provided by the TO is sufficient to allow them to

be able to prepare a robust tender for a project. We do not think that providing bidders with the ability to carry out independent surveys is desirable unless they share the information with other bidders.

The question of the ability to be able to carry out additional surveys is also relevant – one assumes at the bidding stage that a bidder may not have the right under licence to be able to secure access to land to carry out such works either by way of voluntary arrangement or under , and therefore if it is felt that additional surveys are needed, then they may have to be done by the TO under their licence.

*ii. The most efficient process for enabling this?*

If a bidder feels that additional information is required, then Ofgem should take the lead role in determining if the request is reasonable and if so, then additional time should be given to the TO to carry out such works.

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

We have no particular comment to make on the proposals other than that they seem to be the most appropriate way to progress matters, although Ofgem will have a key role to play in determining issues that arise as identified in point “c” above.

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

Whilst TOs are funded for their economic and efficient costs for pre-construction works, they will have to be funded for the provision of the additional activities arising from the preparation of and support to the tender process, and for any additional works that Ofgem/TO identify are required in terms of questions “b” and “c” above.

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

At this stage, we do not see that the risk allocation has been sufficiently identified in order to make detailed comment. We would point out that consideration has to be given to the role of contractors and consultants who support the TO in the delivery of preliminary works – they will have contracted with the TO for the provision of reports and specialist advice and upon the basis of that, the TO will have developed the project specification. Information within these reports will be relied on by the successful CATO both at bid and at eventual delivery so transfer of warranties and liabilities will have to be considered.

Considering that Ofgem will be the contracting party (client) for a tendering process and the winning CATO will be the contractor, it is important that there is a clear definition of responsibilities and liabilities over the preliminary works, between TOs, bidders, CATO and Ofgem.

## Mitigating conflicts of interest – Responses to question 11-13

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

We agree that conflict mitigation measures are necessary when a TO is bidding, in its licensed area, for a project which preliminary works were developed by the same TO. We also agree that these measures should be a combination of obligations of conduct, business separation and scrutiny measures.

SSE plc is already operating a successful Business Separation Policy where restrictions and governance policies are applied within IT systems and physical locations, ensuring confidentiality of data and no cross subsidies. Therefore we believe we have enough expertise to put in place the necessary arrangements to separate any TO bidding party from a TO preliminary work team.

We expect to set up a “TO bidding party” when we decide to tender for the delivery of projects. Although robust arrangements should be put in place, they should be flexible and allow for agile deployment to accommodate the temporary nature of the TO bidding party.

Obligations of conduct: we agree with the proposal, and we do not have any particular comment to make on it.

Business separation measures:

**Information:** In our view, it is possible to guarantee the protection of information through governance policies and by restriction of access to parts of IT systems and network drives, without using a completely independent IT system. This follows from our experience with the business separation requirements of a Vertically Integrated Undertaking.

The methodology document that will be sent by the TO to Ofgem before a tender should detail these arrangements. Such report should also include a specific policy developed to guide employees’ interactions, including an example of the non-disclosure agreements signed by the employees involved in such processes.

**Managerial:** We also believe that it is important to have management of the TO bidding party independent from the management of the TO preliminary works team. We believe that the assignation of an executive director, working exclusively as TO bidding party director during the bidding process, will ensure that there will not be information communicated between the preliminary works and the bidding teams.

We believe that it is appropriate for the bidding party director to report at the Network Board level. This will be sufficient to ensure that the TO bidding party director and the SHE Transmission director (e.g. preliminary works team etc) are working independently with a clear division in management responsibility. We will provide further detail of this proposed structure, including an organization chart, as part of the proposed methodology for addressing conflict mitigation. We would be happy to discuss this further with Ofgem at its convenience.

**Employees:** in general terms, we agree with the terms of the proposal. For RIIO-T1, these restrictions should apply only after the Ofgem minded-to decision to tender a project.

**Physical:** SSE plc successfully uses an access restriction system to keep businesses physically separated and we suggest using a similar approach to avoid contact between a TO bidding party and a preliminary works

team. The teams would be working in separate parts of locations, using badges that limit their access to specific areas.

**Financial:** We agree that any costs incurred in relation to competitive tendering should not be recovered from regulated revenue related to other activities. As such it will be important to put in place some 'ring fencing' measures to separate out the different regulated revenue streams and also to assure that financial information from the TO preliminary works side could not be accessed by the TO bidding party. Considering our experience as part of a Vertically Integrated Undertaking, we believe that it is possible to separate the financial operations within the company, whilst maintaining the same infrastructure thus minimising costs. Regarding the bid costs, we believe that the utilisation of a cost centre dedicated to the TO bidding party costs is an effective way to keep financial separation. Again, we will provide details of the financial separation arrangements as part of our proposed methodology for addressing conflict mitigation.

**Legal:** considering the temporary role of the TO bidding team, we do not think that setting up a separate company is either a practical solution nor would it give extra guarantees in terms of mitigating conflicts of interest. We are confident that the establishment of those measures outlined above will be adequate to ensure that the TO bidding party will not enjoy unfair advantages in the competitive scenario.

*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?*

We believe that SSE plc's governance structures are adequate to supervise and scrutinise the application of business separation activities, measures and policies. Nevertheless, we consider it appropriate that some independent form of scrutiny will give stakeholders and the market more confidence in the competitive process. The vertically integrated transmission and distribution owners are already required to appoint an independent Compliance Officer to ensure that adequate separation measures are in place. The role of the Compliance Officer could be extended also to ensure the independence of the TO bidding team.

*13. Do you agree with our proposal to manage conflicts of other bidders?*

We would expect that similar conflict mitigation measures as those applied by the TOs will apply to bidders that are part of a wider group of companies who control or may have direct access to supplier/contracting companies involved in the preliminary works.

Furthermore, the 'conflict of interest declaration' required at the pre-qualification stage should contain sufficient detail to identify any potential or actual conflicts of interest and that will ensure the bidder understands the importance of the declaration.

## **Mitigating conflicts of interest - Additional comments**

Mitigating conflicts of interest from the SO role: we believe that many potential conflicts of interest could emerge from the enhanced role of the SO and the fact that it is closely affiliated to the England and Wales TO. We note that Ofgem is aware of that and it is working with DECC and NGET to address this issue. We welcome this essential debate and believe that its significant impact on the GB transmission system justifies the participation of all the stakeholders in the discussion. We believe an ISO is the only option that will facilitate a fully competitive model in electricity transmission, assuring that not just the pre-tender arrangements but also the day-to-day operations and the long-term priorities are aligned with the best interest of customers.



## Appendix 3: SHE Transmission critique of updated impact assessment

Scottish Hydro Electric Transmission plc (SHE Transmission) welcomes the opportunity to respond to the updated impact assessment, in the framework of Ofgem's latest consultation on ECIT. We have previously expressed our concerns about the robustness of the regulatory impact assessment (RIA) and our belief that it should be revisited to provide a technically stronger assessment, mainly focusing on the review of the costs-benefit analysis and its justifications, and on the significant differences (and risks) between the OFTO regime and the proposed onshore competition. We also shared our position about the merit of undertaking case-by- impact assessments for each project before the decision to proceed with the competitive process. Whilst we appreciate the elaboration of this updated version of the RIA, our main concerns in these areas remain.

Besides our concerns expressed previously, we would like to highlight other areas where we believe there is room for further improvements. Although Ofgem has reached its policy decision we believe further revisions to the RIA could help to manage the risks, develop a reliable and workable regime and, finally, help to deliver the expected benefits of the ECIT project to consumers.

### Proposed areas for improvements:

#### *Objectives of the proposed regulatory change*

In our view, a more precise description of the outcomes expected from the proposal is key to developing a better assessment of alternatives, risks and future measurements of the efficiency of the policy. The rationale for extending competition is to "reveal appropriate costs, thereby encouraging greater efficiency and innovation, ultimately leading to better value for customers", always protecting the interest of existing and future consumers. We believe further details about the meaning of "better value for customers" are required, especially considering that the definition of customers' interest has several dimensions, including the security of supply and the reduction of greenhouse gases. Thus, we believe it is important to clarify that better value for customers when introducing competition in electricity transmission, is a concept beyond cost saving. It also includes the project delivery in time to support the commitment with renewable targets and a reliable system.

#### *Counterfactual - Alternatives development*

A RIA process usually demands that different ways of reaching regulatory objectives can be compared. We believe that the development of an alternative counterfactual, considering the introduction of regulatory changes without introducing competition, would be the appropriate counterfactual to allow the right level of comparison against the 'preferred option'. The GB transmission system is undergoing significant development due to an increase in renewable energy projects seeking connection: hydro and windfarms in the north; windfarms and solar in the south. We agree that this challenge requires reviewing the current regulatory framework, to ensure that we can bring about timely, more economical and efficient development of the GB electricity transmission system.

In our view, there should be room to think about other regulatory changes that could meet these objectives without the introduction of competition, at least in a theoretical framework. One of the main challenges

and contributions of the regulation field has been the creation of tools to stimulate market conditions where monopolies were justified. Although we recognise the limited capacity of a RIA to deal with complex alternatives, we believe a solution which combines approaches, bringing together regulated and market-based solutions, could be a better alternative to the comparison.

### *Cost assumptions*

Although Ofgem recognises that there are significant levels of uncertainty around the cost estimations (and around the benefits), this uncertainty is not reflected in the cost figures. The scenario analysis considers single points of costs rather than ranges; we think that using ranges in the cost assumptions would lead to a more useful sensitivity analysis.

### *Sensitivity tests and risk impact*

In our view, we are missing a sensitivity analysis of the costs associated with the main risk: the risk of delays or non-delivery. As a "High Impact, Low Probability" event we believe that it justifies its calculation, at least as a "worse case scenario". International evidence, such as competitively-delivered transmission projects in Brazil and Chile, shows that these costs should not be underestimated.

### *Monitoring to evaluate the success of the regulation and formal review*

We believe that it is good practice to assess the real outcomes of the regulatory change against the expected ones. Measuring the results will help to assess the success of the regulation policy and we think that it is worth developing a high-level methodology as soon as possible, to keep in mind the objectives pursued.

We would also strongly recommend a periodic review of the regulatory change is introduced, using, amongst other data, the measures previously collected. Such reviews will identify the need for any refinements and modification to the framework that may become apparent only once competition has been put in place and projects have been tendered and delivered.

### *Other bidder costs – Due diligence*

We believe that it is likely that the winning bidder will want to carry out due diligence over the preliminary works or even over early development works, at least for the part of the works where there is a transfer of risks from Ofgem, TO or SO to the CATO. Thus, this cost should be included within the "bidder costs" and the time required for that should be considered in the competitive process timeline.

### *Other risks*

There are other risks that we believe should be considered, if not as potential "extra-costs" (given that it is very difficult to forecast their costs and probabilities), at least seeking to mitigate them throughout the development of the market offering:

- Bidder curse: we believe that potential bidder curse (over bidding in auctions) could emerge in the tendering process, considering the participation of new players and the complexity of the transmission projects. This could affect both costs estimations and delivery forecasts which, ultimately, will be reflected in an under-priced economical offer. It is important to keep this potential "optimistic" bias in mind and ensure a transparent bidding process that will offer the bidders enough and identical information, along with a comparison bid methodology capable of detecting any such bias and a market offering with the right risk allocations.

### *International experience*

We believe that exploring the international experience in competitive tendering is not just a good opportunity to gather evidence about the success of similar initiatives, but is also a valuable opportunity to learn lessons about failures and problems. Thereby, we would expect, in Appendix 1 of the impact assessment ("Examples of competition in electricity transmission"), the inclusion of a sample of cases where the outcomes were less than expected.

The case of competitive delivery in Brazil, in our view, is a good example of such problems. A model of successful introduction of competition tendering for many years, the country is now facing significant difficulties on its transmission expansion model, summarised as:

- More than 60% of the new transmission line construction projects are suffering delays on delivery, with an average delay of 14 months, compromising the connection of new generators<sup>7</sup>. According to an audit carried on by the Court of Union Account<sup>8</sup>, the losses for all energy developments delayed reached R\$ 8,3 billion between 2009 and 2013 (approx. £ 2,8 billion in 2013 exchange rate);
- Lack of interest of investors, with empty auctions (19 of 38 lots auctioned in 2014 and 2015 did not receive any offer bid)<sup>9</sup> and saving costs lower than expected in some projects (2,04% in average in a lot in 2015)<sup>10</sup>;
- A total of 9 projects non-delivered, due to the bankruptcy protection process of one foreign company, the biggest non-state-owned transmission line operator in Brazil, with about 10,000 kilometres (6,250 miles) of lines in operation and under construction<sup>11</sup>. The process to arrange the handover of the developments is long and will affect the connection of new generators.

Many factors external to the competitive arrangements, which can not be translated to the GB economic, industry and regulatory reality, contributed both to the success in the earliest years and to the problems in the recent ones. Contributing to the good results from 2008 to 2013 were the favourable global market conditions and attractive financing conditions<sup>12</sup>. Despite the fact that Brazil has been running auctions to the delivery of transmission assets since 1999, from 2008 the expansion of the transmission system has accelerated<sup>13</sup>. At the time, when Brazil enjoyed economic growth, the effects of the economic crisis slowed down investment elsewhere in the world. Brazil, therefore, retained domestic investors and attracted international players in search of more appealing returns.

Whilst external factors have been aggravating the problems recent years, internal problems have also surfaced:

---

<sup>7</sup> Source: <http://novojournal.jor.br/economia/62-das-linhas-de-transmissao-em-andamento-no-pais-estao-em-atraso>

<sup>8</sup> TCU report about "Delays to deliver energy development". TCU (2014b). Acórdão 2.316/2014–Plenário. Processo nº TC 029.387/2013-2 (Impacto dos atrasos na conclusão dos empreendimentos de energia). Brasília: Tribunal de Contas da União.

<sup>9</sup> Figure 4 [http://www.acendebrasil.com.br/media/estudos/2015\\_WhitePaperAcendeBrasil\\_15\\_Transmissao\\_Rev\\_1.pdf](http://www.acendebrasil.com.br/media/estudos/2015_WhitePaperAcendeBrasil_15_Transmissao_Rev_1.pdf)

<sup>10</sup> Source: <http://www.brasil247.com/pt/247/economia/194447/Apenas-4-lotes-de-leil%C3%A3o-de-linhas-de-transmiss%C3%A3o-atraem-investidores.htm>

<sup>11</sup> Source: <http://www.reuters.com/article/spain-abengoa-brazil-idUSL8N14346320151214> and <http://www.bloomberg.com/news/articles/2016-02-26/taesa-mulls-acquisition-of-abengoa-transmission-lines-in-brazil> and <http://www.cypressassociates.com.br/noticias/aneel-sees-hurdles-to-selling-abengoa-assets-under-construction/>

<sup>12</sup> Access to finance was facilitated by the national bank BNDES. It offered very attractive financing conditions, including low interest rates, long amortization periods and up to 80% leverage, depending on the project.

<sup>13</sup> Mainly as a consequence of the introduction of energy auctions to wind power development in 2009 (and the subsequent need to connect this rapid growth technology) and the development of new hydro-electric plants distant from the demand centres.

- the current economic and political instability in Brazil;
- strong currency devaluation and limited access to financing sources;
- regulatory changes that reduced, temporarily, the cash flow of some incumbents which prefer to wait for liquidity before bidding for new projects.

In addition, there are many factors intrinsic to the auction process, to the regulatory framework and to the project development that are causing problems. These are summarised below<sup>14</sup>:

Causes of delays on the delivery:

- Significant delays attributed to environmental consenting process and the land rights process. Although it is considered an “external” factor for the industry, it is clear that there was a perverse mechanism in place which either drove the bidders to estimate their timelines wrongly or did not incentivise them to reveal the correct forecasts or to challenge the regulator estimations;
- Delays also occurred in the planning, procurement and construction stages.<sup>15</sup>

Causes of the lack of interest in the auctions:

- The perception of higher risks associated with obtaining environmental licenses and the implementation of projects on schedule;
- The risks associated with regulatory changes that affected the revenues expected by transmission lines in operations, such as harder penalties for outages than the previously set up in their licence conditions;
- The low profitability provided by the cost of regulatory capital used by the regulator to set up the cap price of the auction, and the formal review of the financing capital cost every five years;
- The increasing costs to obtain land rights and the lack of clarity about this process.

Although the transmission system growth, the economic, political and regulatory reality in GB and Brazil are very different, we believe that analysis of Brazilian and other countries’ problems are an opportunity to develop our arrangements with more awareness and caution.

**Conclusions**

We recognise the limitations of a RIA to deal with such complex change in the existing framework and with uncertainties that surround the transmission system development. Nevertheless, we believe that the changes being introduced by the ECIT initiative demand a more robust impact assessment, including acknowledgement of international failures. Such an assessment could help to manage the risks, develop a reliable and workable regime, and help to deliver the expected benefits of the ECIT project to consumers.

---

<sup>14</sup> Source: [http://www.acendebrasil.com.br/media/estudos/2015\\_WhitePaperAcendeBrasil\\_15\\_Transmissao\\_Rev\\_1.pdf](http://www.acendebrasil.com.br/media/estudos/2015_WhitePaperAcendeBrasil_15_Transmissao_Rev_1.pdf)

<sup>15</sup> Source <http://economia.estadao.com.br/noticias/geral,62-das-linhas-de-transmissao-em-andamento-no-pais-estao-em-atraso--diz-aneel,1817776>