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20 February 2018

Dear Matthew

### **Consultation on changes to Standard Licence Condition C27**

Scottish Hydro Electric Transmission plc (SHE Transmission) welcomes the opportunity to respond to Ofgem's latest consultation on the proposed modifications to Standard Licence Condition C27 to implement policy decisions made through Ofgem's Integrated Transmission Planning and Regulation (ITPR) project, and subsequent policy decisions arising from the Extending Competition in Transmission (ECIT) project.

This consultation response should be considered as part of our wider responses to Ofgem's publications<sup>1</sup> developing the two potential alternative delivery models which Ofgem believes could deliver a significant proportion of the benefits of a CATO tender. We note the deadline for responses to the Consultation on changes to Standard Licence Condition C27 (C27 Consultation) is 20 February whilst the deadline for responses to the Hinkley-Seabank project: minded-to consultation on delivery model (HSB Consultation) is 20 March 2018. In the circumstances, this response specifically addresses our concerns in relation to C27 Consultation proposals, however, we reserve our position regarding Ofgem's wider proposals in respect of competition in onshore transmission given the significant change in the methodology of its implementation and the fragmented nature of the consultative process. In particular we will develop our position further through our response to the HSB Consultation and also through further engagement as Ofgem's proposals become more fully understood.

In order to understand whether the further extension of competition in transmission has the potential to benefit energy customers, there is an obligation to proceed on an evidence-based framework with all relevant factors taken into consideration. The process of passing primary legislation would provide the necessary scrutiny required to examine all relevant

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<sup>1</sup> Hinkley-Seabank project: minded-to consultation on delivery model; Consultation on changes to Standard Licence Condition C27; Update on competition in onshore electricity transmission; Guidance on the Criteria for Competition; CEPA report on Cost of Capital Ranges for New Assets within Ofgem Networks Division; which were all published on 23 January 2018.

evidence in order to provide Ofgem with clear guidance on how to exercise its powers to extend competition such that it is clear that customers will benefit. We appreciate that the Government's decision to not proceed with legislation was outside of Ofgem's control, but we would encourage Ofgem to continue to work with Government and the industry to secure the necessary Parliamentary time for legislation before moving forward with proposals to extend competition. We are firmly opposed to the current process that Ofgem is following and we do not support either the proposed changes to the SO's licence or the proposed delivery models that are being consulted upon.

Ofgem's current fragmented approach, with a lack of a clear process that provides an opportunity for all affected stakeholders to make evidence based representation, creates conditions for ongoing challenge and delay as parties rationally seek clarity through available appeal mechanisms. The consequential costs of delays would ultimately be felt by customers.

In response to the changes which Ofgem is proposing to SLC C27, we have outlined our main concerns below and set out our responses to the specific questions in Appendix 1. In general, we have concerns regarding the timing of the proposed licence changes. Consistent with our position that Ofgem should secure primary legislation before moving forward, the fact that licence drafting is developing well ahead of the regulatory or legal framework for the competition process being established is not consistent with the principles of better regulation and poses the risk of unintended consequences and potentially comprising a TO's ability to meet its connection dates with its customers. Therefore we do not believe that the licence modifications should proceed at this stage.

#### **The current activities being undertaken by the System Operator (SO)**

We believe Ofgem has adopted an approach which lacks the scrutiny and rigour required to ensure that it fulfils its statutory obligation to protect the interests of existing and future electricity customers. The SO is evidently not in a position to judge whether an alternative delivery model provides adequate protection of customers interests as it does not have the information or the capability to make that judgement. In this regard, the SO is not assessing the relevant considerations required to judge what projects are "suitable for competition" but rather are making these determinations on a narrow set of criteria.

We also note that the SO has already been undertaking the majority of the activities which are being proposed in the changes to SLC 27 over the last 12-18 months, in the absence of any regulatory or legal framework to do so but at the request of Ofgem. This includes a recommendation of projects which the SO believes meets the competition criteria, and has subsequently included in the Network Options Assessment (NOA) report for both this year (17/18) and the previous year (16/17). We cooperated with these exercises in good faith, whilst reserving the right to withdraw cooperation if we had concerns with the approach taken by the SO. We have worked with the SO to improve the transparency of its approach to identifying projects that are suitable for competition, successfully arguing for the

opportunity to participate in the NOA Committee. We also have concerns over the current CBA methodology being used by the NOA. This methodology currently uses the Spackman<sup>2</sup> approach which is not reflective of the actual costs faced by consumers.

The NOA process is the principal route to identify the system needs and the suitability of projects for tendering. We are concerned about the submission of detailed project costs by the TOs to the SO, 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. Under the existing arrangements, our view is that the process proposed for identifying options, carrying out early development 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 the TOs (and potentially 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. As outlined within our response<sup>3</sup> to Ofgem's informal consultation on ESO licence drafting, we support Ofgem's decision to instil clear legal and regulatory separation of the Electricity System Operator (ESO) within the National Grid Group and the outcome of this consultation should address this concern.

### **Generation and demand connections**

We acknowledge that the ITPR final conclusions suggested that generation connection offers would be subject to competition in the longer-term, however there was no indication that this would be progressed during RIIO-T1. There has been insufficient process to now take this to licence consultation.

Therefore, we are strongly opposed to the inclusion of demand and generation connections in the scope of this licence condition. In line with our overarching concerns around the general disjointed approach adopted by Ofgem, outlined above, we feel it is essential that generators and customers are provided with the opportunity to respond. As Ofgem has been developing the alternative methods for delivering competition on the back of the Hinkley Seabank (HSB) Case Study, only directly interested parties to the HSB project have been afforded the opportunity to respond. In addition, generators and demand customers should also be encouraged to comment on Ofgem's repackaging principle which may have an impact on the funding available in RIIO-T1 for projects which have been split into separate packages of work or potential delays to these works.

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<sup>2</sup> The Joint Regulators Group on behalf of UK's economic and competition regulators recommend a discounting approach that discounts all costs (including financing costs as calculated based on a Weighted Average Cost of Capital or WACC) and benefits at HM Treasury's Social Time Preference Rate (STPR). This is known as the Spackman approach.

<sup>3</sup> [https://www.ofgem.gov.uk/system/files/docs/2018/02/2018-01-26\\_ssen\\_response\\_to\\_eso\\_0.pdf](https://www.ofgem.gov.uk/system/files/docs/2018/02/2018-01-26_ssen_response_to_eso_0.pdf)

### **Repackaging Principle**

We note that this consultation, and the proposed licence conditions, does not consider Ofgem's approach to "re-packaging" projects. In its November 2016 decision document<sup>4</sup>, Ofgem confirmed its proposal that the SO, as part of the NOA process, should propose the most appropriate project packaging in the first instance. We recommend that the SO's licence condition should also include a clause allowing it to formally undertake such a proposal. Our concerns regarding the means for delivering the remainder of a project which no longer meets the SWW threshold (where there is splitting / repackaging of projects for competition) remain. It is our view that, to the detriment of customers requesting reinforcements to the network, adequate funding might not be available in RIIO-T1 for projects which have been split into separate packages of work. Furthermore, suggesting that such projects could be delivered in RIIO-T2 could introduce unnecessary and potentially detrimental delay to developers and/or consumers.

To summarise, SHE Transmission is firmly opposed to the current process that Ofgem is following and we do not support the proposed delivery models that are being consulted upon. We suggest that Ofgem continues to work with Government to secure the necessary Parliamentary time for legislation before moving forward with its various proposals to extend competition in onshore transmission. The proposed licence modifications to C27 should not proceed at this time.

Please do not hesitate to get in touch should you have any questions regarding our response.

Yours sincerely

Sam Torrance  
Regulation

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<sup>4</sup> [https://www.ofgem.gov.uk/system/files/docs/2016/11/ecit\\_november\\_2016\\_decision.pdf](https://www.ofgem.gov.uk/system/files/docs/2016/11/ecit_november_2016_decision.pdf)

## Appendix 1

### **Question 1: What are your views on our proposed licence modifications, as outlined in this document, and whether they effectively implement the SO-related policy decisions in our November 2016 Decision Document?**

We understand the intent of this document and proposed changes to SLC C27 is to implement policy decisions made through Ofgem's Integrated Transmission Planning and Regulation (ITPR) project and its Extending Competition in Transmission (ECIT) project. However, as indicated in our cover letter, our view is that Ofgem should continue to work with Government to secure the necessary Parliamentary time for legislation before moving forward with the development of competition in onshore Transmission. We do not believe that the licence modifications should proceed at this stage.

### **Question 2: What, if anything, do you think is missing from our proposed licence modifications to implement our policies?**

As outlined above, we do not believe that the licence modifications should proceed at this stage. We have outlined our main concerns regarding the proposed licence modifications within the covering letter, but we believe that the current licence modifications do not effectively cover the following points:

- The proposals are ahead of legislative change and include licence proposals which have not been consulted upon or subject to Regulatory Impact Assessment (RIA).
- We are strongly opposed to the inclusion of demand and generation connections in the scope of this licence condition, as this has not been subject to a consultation process.
- We note that Ofgem has not included any provision for the "repackaging" principle, although Ofgem's policy decision is that the SO will propose the most appropriate project packaging in the first instance via the NOA process.

We believe that once the consultation is closed, a further licence drafting working group should be convened prior to the issue of any statutory consultation. For the avoidance of doubt, we do not believe that the statutory consultation should be initiated prior to such a working group meeting and the points outlined above being addressed.

### **Question 3: What do you think of the newly explicitly noted points 16(a)(vi)-(viii)? Are there any other points that should be captured in addition?**

Our views on the newly explicitly noted points 16 (a)(vi)-(viii) are consistent with our views in response to question 6 below.

For 16(a)(vi), for options which involve the uprating or replacement of an existing asset or the build of a new asset, a disagreement between the TO and SO should not be escalated in this way as this would require the SO to undertake additional development work at an increased cost to the consumer. If escalation is required then this should be brought forward to the planning authority (with the case made by the TO and SO) before any further development work is carried out.

For 16(a)(vii), again, although this involves an option which crosses two or more transmission areas, options which involve the uprating or replacement of an existing asset or the build of a new asset should be developed by the associated TOs. This will involve cross TO collaboration, and continued collaboration with the SO, whereby if there is a disagreement which cannot be resolved by the parties involved, then this can be escalated to the planning authority.

For 16(a)(viii) “options suggested by other interested persons”, we believe that Ofgem needs to define who it means by “interested persons” as this term is extremely vague as it currently stands. As a minimum the “interested persons” would need to have appropriate knowledge of the transmission area and the local environment before an option can be suggested, to ensure that this does not lead to unnecessary work.

**Question 4: What are your views on the form of the criteria as set out in the draft criteria guidance (published as a subsidiary document to the January 2018 competition document published alongside this consultation)?**

Generally, we agree on the form of the criteria set out in the draft criteria guidance. We welcome Ofgem’s decision to set a consistent high value threshold across all of the UK for competitive tendering of onshore transmission assets during RIIO-T1.

However, we would recommend that this criteria guidance is expanded to consider some of the decisions made in relation to the “packaging” of projects (re-packaging; splitting; and bundling). For example, the guidance should be expanded to reflect Ofgem’s view that if projects are bundled together, each constituent package should meet the high value threshold.

We would also encourage Ofgem to ensure that the draft criteria guidance is consistent with the outputs from the ENA ECIT working groups, in which Ofgem was a participating party.

**Question 5: What are your views on our proposed new paragraph 16(e) regarding the assessment of generator and demand connection offers against the criteria for competition? Would this amendment capture all appropriate connections?**

As outlined within our covering letter, we are strongly opposed to the inclusion of demand and generation connections in the scope of this licence condition. In line with our overarching concerns around the general piecemeal approach adopted by Ofgem, outlined above, we feel it is essential that generators and customers are provided with the opportunity to respond. As Ofgem has been developing the alternative methods for delivering competition on the back of the HSB Case Study, only directly interested parties to the HSB project have been afforded the opportunity to respond. In addition, generators and demand customers should also be encouraged to comment on Ofgem's repackaging principle which may have an impact on the funding available in RIIO-T1 for projects which have been split into separate packages of work or potential delays to these works.

We recommend that Ofgem should consult on this separately with the intention of the SO identifying generator and demand connections that meet its criteria for competition in RIIO-2, once the potential implications of this have been fully identified and addressed.

**Question 6: What are your views on our proposed amendment to extend the principle of early development to any option that is not developed by the relevant TO, where the SO considers there may be benefits to developing that option further?**

TOs already have a legal<sup>5</sup> and regulatory<sup>6</sup> requirement to develop and maintain an efficient, coordinated and economical transmission system. For options which involve the uprating or replacement of an existing asset or the build of a new asset, the current provision allows the SO to challenge the TO and the options created. If the SO believes that there may be benefits to developing an option further which the TO is not developing, and if the TO does not cooperate, we think it is more efficient for the SO to be able to escalate this to the planning authority rather than to undertake additional development work, which can already be undertaken by the TO. This will result in increased costs to the SO and therefore the consumer.

It is the expectation however, that through an iterative process of challenge and review, the TO and SO should be able to reach an agreement. Whereas the SO has a detailed knowledge on the operation of the system, the TO has a detailed knowledge on system design, development, and the environment in its licence area.

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<sup>5</sup> S2 Electricity Act 1989.

<sup>6</sup> SLC Condition B7: Availability of Resources