



Making a positive difference
for energy consumers

Gwneud gwahaniaeth gwirioneddol
i ddefnyddwyr ynni

To all holders of an electricity
transmission licence and other
interested stakeholders

Email: NTIMailbox@ofgem.gov.uk

Date: 12th February 2019

Dear licensees and stakeholders

Statutory consultation on a proposal to modify standard condition C27 (*the Network Options Assessment process and reporting requirements*) of the electricity transmission licence and publication of the Guidance on the Criteria for Competition

We¹ are proposing to modify standard condition C27 of the electricity transmission licence (“**C27**”). Alongside this letter, we have published a notice of a statutory consultation on our proposal (“**Notice**”).

We are also publishing the Guidance on the Criteria for Competition (the “**Criteria Guidance**”), which is referred to in our proposed modifications to C27.

This letter provides, in relation to our proposed modifications to C27, an overview of the proposals including a summary of the responses to our previous January 2018 consultation² and an update on developments since that consultation. To provide views on our proposals for C27, please use the details in the Notice published alongside this letter.

This letter provides, in relation to the Criteria Guidance, an overview of the guidance and the feedback which we received in response to our January 2018 consultation on the draft guidance.³

The final implementation of our proposed changes to C27 will take into account our work on ESO separation.

Background on proposed modifications to C27

C27 sets out requirements regarding the Network Options Assessment (“**NOA**”) report, which is published each year by the National Grid electricity System Operator (“**SO**”).

¹ References to the “Authority”, “Ofgem”, “we” and “our” are used interchangeably in this document. The Authority refers to GEMA, the Gas and Electricity Markets Authority. The Office of Gas and Electricity Markets (Ofgem) supports GEMA in its day to day work. This decision is made by or on behalf of GEMA.

² <https://www.ofgem.gov.uk/publications-and-updates/consultation-changes-standard-licence-condition-c27>

³ https://www.ofgem.gov.uk/system/files/docs/2018/01/draft_criteria_guidance.pdf

We have been developing changes to C27 to implement policy decisions made through our Integrated Transmission Planning and Regulation (ITPR) project and our Extending Competition in Transmission (ECIT) project.

From 25th November 2016 to 27th January 2017 we consulted on a set of proposed amendments to C27.⁴ Following consideration of the responses to that consultation, and further consideration of the structure of the proposed amendments we consulted on a further set of changes to C27 between 23 January 2018 and 20th February 2018 (the “**January Consultation**”).

Summary of the proposed modifications

In summary, the proposed modifications fall into four parts:

1. Restructuring parts of C27 to provide a non-exhaustive list of the types of options for Major National Electricity Transmission System Reinforcements (“MNETSR”) that the SO should set out in the NOA report.

This proposed modification is intended to increase clarity.

As stated above, the list is non-exhaustive and does not seek to define what constitutes an option for MNETSR. For the avoidance of doubt, any other types of option for MNETSR not included in the list can be included in the NOA report.

The existing C27 does not seek to define what constitutes an option for MNETSR. It does refer to four types of option that should be seen as options for MNETSR, although these are not set out together in a numbered list.

The proposed modifications to C27:

1. bring the four types of option mentioned in the existing C27 together into a numbered list;
2. add a further four types of option, which are not referred to in the current C27. Table 1 of the January Consultation provides further explanation of the intended meaning behind these three types of option.

The types of option listed are not mutually exclusive. In other words, an option could fall within more than one of the types listed.

2. A new requirement for the SO to assess certain projects set out in the NOA report against the criteria for competition, as described in the Criteria Guidance.⁵

This is intended to implement our previous policy decisions that the SO should make a recommendation on which, if any, of the projects that it recommends should be developed further meet the criteria for competition. We additionally propose to implement the same SO criteria assessment for generator and demand connections, as decided in our November 2016 policy decision document.⁶

⁴ <https://www.ofgem.gov.uk/publications-and-updates/consultation-licence-changes-support-electricity-transmission-competition-during-riio-t1>

⁵ The criteria for competition are New, Separable, and High Value. More detail on the definitions of each of these criteria is available in the Criteria Guidance document published alongside this statutory consultation.

⁶ https://www.ofgem.gov.uk/system/files/docs/2016/11/ecit_november_2016_decision.pdf

We note that the SO has already undertaken and published the assessment of projects set out in the January 2018 and January 2019 NOA reports. This was also included in the NOA methodology consultation published in July 2018.⁷

3. A new requirement for the SO to undertake early development of options it intends to set out in the NOA report where early development is not carried out by another transmission licensee.

This is intended to implement our November 2016 decision that the SO should be responsible for undertaking early development of alternative or reduced build solutions to meet system needs.

The aim behind the new requirement is to promote the inclusion of the widest possible range of solutions in the NOA. Such options might include, for example, whole-system or commercial solutions, and options recommended previously by the SO to proceed but which have not been progressed by the relevant TO to which the recommendation was given.

The requirement helps to achieve this aim by ensuring that these options are sufficiently developed such that they can be compared to other options as part of the NOA. This requirement represents an extension of the existing requirement in C27 for the SO to undertake early development for 'Non Developer-Associated Offshore Wider Works'.

4. Structural and housekeeping changes. We propose a series of modifications to clarify requirements within C27, for example on the provision of data to the authority.

A marked-up and a clean version of C27, showing our proposed modifications, are enclosed as Appendices 1 and 2 of the Notice published alongside this letter.

January Consultation

We set out proposals to modify C27 in our January Consultation. Having considered the responses to the consultation we continue to consider that our proposals are appropriate overall, but we have made some changes to the proposals on which we consulted in January.

A discussion of the points raised by respondents and our response to those points is provided below.

Responses to our January Consultation

We received responses to our January Consultation from the three incumbent onshore transmission owners (TOs), the SO⁸ and one Distribution Network Operator (DNO). We have published the responses on our website.⁹

Since the consultation, we have engaged informally with all respondents to discuss the views expressed in their individual consultation responses.

In the remainder of this section we set out the main points raised by stakeholders in response to our January Consultation (including, where appropriate, additional detail

⁷ <https://www.nationalgrideso.com/sites/eso/files/documents/NOA-methodology-July-2018.pdf>

⁸ The response from National Grid was a joint TO-SO response.

⁹ <https://www.ofgem.gov.uk/publications-and-updates/consultation-changes-standard-licence-condition-c27>

provided during subsequent engagement) alongside our views on the points. Where relevant we provide a description of how our proposals have changed following our January Consultation.

Competition and process related responses

Two respondents considered that we should not make our proposed modifications to C27 until Parliament has passed the Competitively Appointed Transmission Owner (CATO) legislation.¹⁰ The respondents said that the changes in C27 are intrinsically linked to the CATO form of competition developed between 2015 and 2017.

Our proposed changes will require the SO to give its view of which, if any, of the projects that it recommends should be developed further meet our 'criteria for competition'.¹¹ As set out in our competition update in January 2018, we consider that those criteria remain appropriate for identifying projects that may be suitable for delivery through our Competition Proxy and/or SPV delivery models. We therefore consider that the changes being made here remain relevant even without the CATO legislation.

Two stakeholders stated that the process for identifying projects using the criteria for competition should include an assessment of the costs and benefits of applying competition to that project. One of the responses specified that this assessment should occur prior to a decision to tender a project. Our proposed changes to C27 would require the SO only to give its best view of which, if any, projects meet the criteria for competition. It is our role, as regulator, within the process to decide whether a project meets the criteria, and which delivery model will be applied, including considering the benefits and risks to consumers.

One respondent stated that C27 should include a requirement for the SO to undertake its assessment of projects against the criteria for competition in line with the repackaging principles set out in our November 2016 decision document. To-date, this has been included by the SO as part of its NOA methodology. Our view is that the NOA methodology is the correct place to include this, and we expect this to be included as a part of all future NOA methodologies.

Connections related responses

One respondent questioned whether it is appropriate to include generator and demand connections in the NOA, given that the NOA is underpinned by the probabilistic Future Energy Scenarios (FES) rather than absolute generation and demand background. Our view is that, provided the SO is suitably clear in its report, the NOA can include both probabilistic and absolute requirements. We note that the NOA methodology for 2018/19 sets out one possible way to include connections in the report, which we consider could act as a reasonable starting point.

One respondent considered that we should undertake further consultation on the proposed process for integrating connections with the NOA, and should only implement connections into the NOA for RIIO-T2. Two other respondents set out their views that we should consider further how the NOA interacts with the existing connections processes. We consider that stakeholder engagement with the SO on its NOA methodology is the best way to ensure that the SO's proposed method for integrating connections can work for all

¹⁰ In June 2017 we published an update on competition stating that we were pausing development on the CATO regime until such time as we had further clarity on the timetable for the CATO enabling legislation: <https://www.ofgem.gov.uk/publications-and-updates/update-extending-competition-transmission>

¹¹ Our criteria for competition are: new, separable, and high value. More details on the definitions of these criteria are set out in the accompanying Criteria Guidance.

parties. Our view is that there is a benefit to starting to develop and refine the processes for connections within the NOA now.

Responses related to early development work

One respondent considered that it was not appropriate for the SO to take forward projects that the relevant TO did not pursue, and that instead the disagreement should escalate to another arbiter. Similarly, most stakeholders noted that they did not know of any instances where the TO had not taken forward projects identified by the SO through the NOA report.

The scope of the requirement is intentionally broad because we want the widest possible range of options to be included in the NOA. We acknowledge that there have been no instances where a TO has not progressed a recommendation by the SO but we want to make sure that, were that to happen, the project would continue to be suitably developed such that consumers would not lose out on potential benefits.

One respondent requested further clarity on the scope of works that would comprise any early development works. In our November 2016 decision, we said that *"...these early development works will principally be desk-based analysis"* and that *"...this will enable the SO-led options to be compared with other options under the NOA process"*.

We have amended the proposed changes from our January Consultation to clarify that the purpose of the requirement for early development work is to enable options to be adequately compared.

Our view is that the SO is best placed to understand the scope of development for any given option to allow it to compare the option with others. The SO should continue to develop its approach through the NOA methodology. Stakeholders and Ofgem will be able to input into that process.

One respondent said that the options described by paragraph 16(a)(v) ("options that require liaison with a holder of a distribution licence on distribution system solutions") should be developed by or in conjunction with the relevant DNO, rather than by the SO in isolation. We note that there is substantial work being undertaken within industry to explore routes for these cross-sector solutions, for example through the ENA's Open Networks project.

Responses related to the term "interested persons"

Three respondents raised questions related to the term "interested person" found in the new paragraph 16(a)(viii). In summary, respondents considered that Ofgem should:

- define interested persons;
- detail the process by which interested persons would be able to submit proposals; and
- consider whether it is appropriate or efficient for the SO to be required to analyse all options submitted by possible interested persons.

In respect of all of the points raised by respondents, our view is that the SO is the party best placed to define the process for submitting proposals and appropriately filter out submitted options before setting them out in the NOA report. As we stated in our January consultation, *"In relation to [interested persons], we note that the obligation in subparagraph 16(a) is (in summary) for the licensee to set out its best view of options that could meet system needs. Consistent with this, for the avoidance of doubt, it is not our intention that the SO set out all options suggested by interested persons"*.

Responses related types of options

One stakeholder noted that they considered the wording of the option related to interconnector capacity to be different to the agreed scope of the SO's role in relation to identifying interconnector capacity. Having reviewed the proposed drafting, for the purposes of clarity we no longer intend to move the interconnector wording into the non-exhaustive list of types of option within 16(a).

Two stakeholders considered that the drafting of the proposed amendments to the NOA appeared to exclude transmission options. This was not our intention. To provide clarity to stakeholders that the NOA should include any transmission build options, we propose to include an explicit reference to those types of options at point (ii) in the list in paragraph 16(a).

Criteria for Competition guidance document

Background

One of the conclusions from our ITPR project in 2015 was that it is in consumers' interests to extend the use of competition to onshore electricity transmission assets that are new, separable, and high value. Our view was that tendering onshore assets that are new, separable, and high value would mean that benefits from tendering such as cost savings and innovation would outweigh the administrative and interface costs of competition. Following consultation, we published draft definitions of the new, separable, and high value criteria for competition in November 2016.

In our January 2018 update, we confirmed our view that the criteria are appropriate for identifying projects that may be suitable for delivery through our Special Purpose Vehicle (SPV) model and Competition Proxy model (CPM). Alongside the update we published, for consultation, our proposed Criteria Guidance, which contains definitions for the criteria.

Responses to the consultation on the draft Criteria Guidance

Stakeholders accepted that the Criteria Guidance correctly defined the criteria for competition in line with previous policy decisions.

One respondent recommended that we also include guidance in relation to how we make decisions on the "packaging" of projects, for example, re-packaging, splitting, and bundling. We consider that the Criteria Guidance should be focussed solely on the application of the criteria for competition. We consider that it would not be the appropriate place to include guidance on our selection of the whole or part of the project to be competed on a project-by-project basis.

One respondent said that we should have included a cost-benefit analysis to support the implementation of the criteria. We have previously undertaken several cost-benefit analyses in support of our proposals to extend competition in transmission. As part of our ITPR draft conclusions in 2014¹² we published an assessment of the impacts of introducing competition and the rationale for the criteria, and updated this assessment as part of our

¹² https://www.ofgem.gov.uk/sites/default/files/docs/2014/09/itpr_draft_conclusions_sept_2014.pdf

ITPR final conclusions in March 2015.¹³ We undertook two further impact assessments as part of our ECIT project, firstly in May 2016,¹⁴ and September 2018.¹⁵

One respondent queried our approach of creating a separate Criteria Guidance document, rather than as a part of the C27 condition itself. Another respondent said that we should make clear the process by which the Criteria are reviewed and amended. The Criteria Guidance helps stakeholders to understand how Ofgem makes decisions about the appropriate delivery model for a project. In relation to C27, the reference to the Criteria Guidance provides for the SO to carry out an assessment of projects against criteria set down, and potentially updated from time to time, by Ofgem, following consultation. To address stakeholders' concerns, we intend to include a reference within the licence to consulting on changes to the Criteria Guidance document. We will consider separately how the Criteria are applied, referenced, and reviewed in RIIO-T2 as part of that development process currently underway.

Yours sincerely,

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¹³ <https://www.ofgem.gov.uk/publications-and-updates/integrated-transmission-planning-and-regulation-itpr-project-final-conclusions>

¹⁴ https://www.ofgem.gov.uk/system/files/docs/2016/05/extending_competition_in_electricity_transmission_updated_impact_assessment_0.pdf

¹⁵ <https://www.ofgem.gov.uk/publications-and-updates/update-extending-competition-transmission-and-impact-assessment>