

By Email to: [RIIO2@ofgem.gov.uk](mailto:RIIO2@ofgem.gov.uk)

13<sup>th</sup> March 2019

To whom it may concern

**RIIO2 Sector Specific Methodology Consultation – Driving innovation and efficiency through competition**

As part of the Transmission Capital Partners consortium, Transmission Investment manages one of the largest offshore electricity transmission portfolios in terms of the capacity of offshore wind connected. Our managed portfolio of Offshore Transmission Owner (OFTO) assets includes the connections to the Robin Rigg, Gunfleet Sands, Barrow, Ormonde, Lincs, Westernmost Rough and Dudgeon offshore wind farms - a portfolio of approximately 1.5GW (£1.1bn in capital employed).

Transmission Investment also remains a strong advocate of introducing competition into the delivery of onshore transmission and we continue to support the development of the required arrangements *inter alia* through industry groups, responding to consultations such as these and, when called upon, providing evidence to parliament.

Transmission Investment is leading, in partnership with the French national grid company RTE, the development of a proposed 1400MW HVDC interconnector between France and Britain via Alderney ("the FAB interconnector project"). This project was granted cap & floor regulatory treatment in 2015 and whilst it continues to experience Brexit related delays, it will commence construction as soon as the regulatory process allows.

As such we are very supportive of the work that Ofgem has done to date and is planning to carry out to introduce competition into monopoly areas and we support the proposals set out in the RIIO2 Sector Specific Methodology consultation with respect to driving innovation and efficiency through competition.

Our detailed responses are included in Annex A to this letter where we respond to the specific questions raised in Chapter 8 of the Consultation document (and elaborated on in Appendix 2 and the accompanying Impact Assessment).

In addition to these detailed responses we would like to make the following points;

- i) We consider that there is benefit in opting initially for the late model and gaining significant experience of this model before moving to an early model. The OFTO regime has provided a sound base from which to extend competition in energy networks, both onshore and into the

procurement and construction phases of these projects. However, we would consider it prudent and advisable that experience is gained from the late model prior to implementation of the early model. Our only caveat to this is that a two-stage early model, in which the second stage is a late model, does not have the same deliverability and cost control risks that a single stage early model would have.

- ii) We believe that the market which might respond to these competitive opportunities would greatly value more visibility on the potential pipeline of projects coming forward. In the Electricity Transmission (ET) sector this is emerging through the annual Network Options Assessment (NOA) publication and we would like to see a similar process for identifying projects for competition in the other three RII02 sectors. The market is unlikely to spend significant effort in preparing for forthcoming tenders without this visibility.
- iii) We understand that there will be a drive to make go/no-go decisions on the funding and delivery models of projects as late as possible in order to reduce the possibility of inefficient investment. In the electricity transmission sector, there have been two projects which Ofgem has either decided to, or is minded to, use the Competition Proxy Model delivery route, essentially due to a lack of time to implement a real competition. Consideration should be given as to how to ensure that a lack of time can never be a reason to avoid a real competition.

If you would like to discuss any of the comments above or in the attachments to this letter please feel free to contact me.

Yours sincerely



**Chris Veal**  
Managing Director

## Annex A – Responses to specific questions

Question	Response
<p>CSQ51. Have we set out an appropriate set of models for both late and early competition to explore further?</p>	<p><i>We have interpreted this question as seeking views on the range of models available for competition which essentially includes the following:</i></p> <p><i>Late: Competition Proxy, CATO, SPV</i></p> <p><i>Early: Two-stage (probably comprising a Very Early stage and a Late stage<sup>1</sup>), Single stage</i></p> <p><u>Later models</u></p> <p>There are examples of later stage models not described in the consultation document, which could provide benefits within the RIIO2 sectors. We are not specifically advocating any of these but for completeness these would include:</p> <ul style="list-style-type: none"> <li>• A model under which the network company procures and constructs the project in its own area, but a third party provides financing and carries out operational activities (but is not exposed to construction risk). This is akin to the OFTO regime but with the network company in the role of the offshore wind developer;</li> <li>• A model under which the network company procures the project and a third party finances, constructs (and takes construction risk) and operates the project. An example of this would be the delivery model adopted for the Thames Tideway project.</li> </ul> <p>Clearly there is less scope for the benefits of competition in these later models, although arguably costs of capital would be lower. They could however provide further options, particularly where timescales and/or design responsibility prevent the use of an earlier model.</p> <p><u>Intermediate model</u></p> <p>There is also an intermediate early-late model in which the solution has been selected by the TO or ESO (e.g. a new line between A and B), but the development work has not been undertaken and consents have not been obtained. Again, this is included for completeness but we do not advocate it.</p>
<p>CSQ52. Do you agree with the proposed criteria we have set</p>	<p><i>We have interpreted this question as seeking views on the proposed criteria for individual projects to be</i></p>

<sup>1</sup> Page 150 of the consultation document, Appendix 2 where Ofgem states “Our current expectation is that the second stage of competition (for delivery) could operate like a late competition”.

Question	Response
<p>out for assessing the suitability of <u>late</u> competition models? Would you suggest any other criteria, and if so, why?</p>	<p><i>suitable for (a late) competition, as opposed to determining whether a late or early competition would be more appropriate for a given project.</i></p> <p>In general we agree with Ofgem’s assessment that the criteria for competition for a late project should be the same across the ET, GT, GD and ED sectors.</p> <p>The decision to compete a project is, in part at least, dependent on the balance of the costs and benefits to consumers from running a competitive process. The £100m (capex) threshold level has been set in respect of electricity transmission, which we would argue is the most complex sector of the four under consideration, and therefore is likely to have the highest costs of competition. It would be worth considering whether competing projects in the other three sectors could be carried out at a lower cost, and therefore with a lower capex threshold. We note that in the water industry, Ofwat is using a £100m totex threshold value which should therefore capture smaller projects.</p> <p>However, we do also see the benefit in keeping consistency across these three sectors.</p>
<p>CSQ53. Do you have any views on the costs and benefits we have used for our draft impact assessment on late competition?</p>	<p>[cf chapters 3 &amp; 4 of the IA]</p> <p>We note that this question only relates to the impact of the introduction of late models.</p> <p><u>Scenarios considered</u></p> <p>We assume that the scenarios considered in the impact assessment contain project pipelines that cover all four sectors – e.g. scenario 1 contains only one ET, GT, ED or GD project competed in the RIIO-2 period.</p> <p>Whilst we understand that Ofgem would want to look at a ‘downside’ scenario, we consider that the two scenarios in which only one £100m project is competed (scenarios 1 and 6) should not be realistic. If this really is a possible outcome then irrespective of the cost-benefit analysis conducted here, most stakeholders would consider it not to have been a worthwhile exercise when one considers the human resources / time required in one-off activities such as devising suitable competition arrangements.</p> <p>It would be helpful if Ofgem could provide greater clarity on what the likely number and size of the RIIO2 competed projects pipeline in total might be. As noted in the covering letter, the NOA provides this for the</p>

Question	Response
	<p>Electricity Transmission sector<sup>2</sup> and it would be useful to have an indication of the expected pipeline in the other three sectors. For example in devising its Direct Procurement for Customers (DPC) arrangements, Ofwat gave an indication of the scale of the DPC pipeline based on what would have been competed using the DPC criteria for competition in previous price review periods.</p> <p><u>Costs</u></p> <p>We assume that the Ofgem model ‘design’ costs for all sectors of £4m is yet to be incurred as otherwise it should be treated as a sunk cost and therefore ignored.</p> <p>We also assume that unsuccessful bidder costs have not been included as they are not ultimately borne by the consumer (other than through the successful bidder’s margins which would normally be set to recover bid costs on unsuccessful bids).</p> <p>With respect to interface costs, we have two significant interfaces on each of our OFTOs, with the onshore network owner (NGET or the local DNO) and with the offshore wind farm itself. For an OFTO these do not give rise to any significant interface costs.</p> <p><u>Benefits</u></p> <p>We note that paragraph 3.10 of the impact assessment recognises that competition may increase the range of suppliers considered. We would also add that it would provide a strong incentive to adopt more cost-efficient designs, specifications, and working practices, that would bring benefits when compared to tendering by an incumbent licensee.</p> <p>Apart from the scenarios with only one project, tendering costs are only 4-5% of capex. Given the benefits of the OFTO regime (19-23% of FTV<sup>3</sup>), in which only financing and opex are competed, and assuming competition in ideas, solutions, procurement and construction would create further benefits, the case for competition appears overwhelming.</p> <p>We would expect competition in the construction phase to potentially bring additional benefits. We note the bottom end of the 4% to 19% assessment in the ET SPV</p>

<sup>2</sup> Although the NOA may also need to be expanded if, as Paragraph 112 of the Annex specifically relating to Electricity Transmission notes, it is possible that some mitigation projects might meet the criteria for competition, as we do think believe that the NOA would currently capture this.

<sup>3</sup> Final Transfer Value which includes IDC and development costs as well as pure capex. Benefits as a % of capex alone would have been higher.

Question	Response
	<p>impact assessment<sup>4</sup> did not assume any capex or opex savings which we consider to be too conservative.</p> <p>We believe there is experience from South America that the benefits of a late model competition can be significant.</p> <p><u>Cost-benefit</u> With any reasonable pipeline, we believe the cost-benefit case is compelling.</p>
CSQ54. Are there any considerations for a specific sector we should include in our IA?	We have no additional considerations to suggest.
CSQ55. What are your views on the potential issues we have raised in relation to early competition? How would you propose mitigating any issues and why? Are there additional issues you would raise?	<p><i>[cf p 148 – Deliverability, Access to land, Change in circumstances]</i></p> <p>The three potential issues raised in Appendix 2 (Deliverability, Access to land, Change in Circumstances) in our view make a two-stage early model more compelling than a single stage model.</p> <p><u>Deliverability</u> Provided Intellectual property rights are adequately managed as part of the tender / consultation process, we do not see unmanageable issues in the party providing the winning idea not being the party delivering the solution. There would however need to be a third-party assessing deliverability of the proposed idea before it being selected for the second stage. We would expect this deliverability assessment to be necessary even in a single stage competition.</p> <p><u>Access to land</u> For robust and competitive tenders under an early competition model, it is important that bidders have equal access to information relating to the land they may need. Under a two-stage process, this information can be provided by a network licensee prior to the second stage being run. Any issues which may result in the preferred idea being undeliverable due to access to land could also be identified at that point.</p> <p><u>Change in Circumstances</u> Change in circumstances will inevitably happen. In order to mitigate the impact of such change, it is important to carefully consider the timing of any cost commitments with a view to retain the flexibility to amend preferred solutions or designs for as long as</p>

<sup>4</sup> Impact Assessment on applying the Special Purpose Vehicle model and Competition Proxy model to future new, separable and high value projects, Ofgem, 14 September 2018

Question	Response
	<p>possible, without negatively impacting the level of engagement of participants (discouraging participation by interested parties). This make a two stage process more attractive as the party committing the largest proportion of expenditure is selected at a later stage. Even under this model, there should be mechanisms that deal with necessary changes in circumstances through reopeners, retendering (if necessary) or even cancellation. We would expect the winning bidder to be suitably compensated for these changes.</p> <p><u>Other issues</u></p> <p>In the single stage early model, we see a particular need to achieve a balance between the control of cost and size of risk margins. For example, if bidders are asked simply to provide a fixed price for a single stage early project then they may require to include a significant risk margin in the price to deal with delivery uncertainties. If bidders are only required to bid on a rate of return/cost of capital basis, then there will be less incentive to control any pass-through costs. This could be mitigated by having a set of pre-defined milestones allowing any increased costs above the bid target cost to be shared between the bidder and Ofgem thereby retaining incentives on the winning bidder to control costs. Ofgem could define a cost limit/threshold (after sharing mechanism) where Ofgem would have the option to require a retender. The defined milestones would need to be set pre-financial close, such as obtaining all necessary consents and land rights.</p>
<p>CSQ56. Are there other potential drawbacks of early competition?</p>	<p><i>We have interpreted this questions as to the drawbacks of using an early competition model compared to a late competition model</i>  <i>Cf 8.73, 8.74</i></p> <p>We view a two-stage early competition made up of a competition for ideas, followed by third party obtaining consents and land rights prior to a late competition being run, as not having any drawbacks over a late competition.</p> <p>In respect of a single stage early competition, we see the following drawbacks compared to a late competition.</p> <ul style="list-style-type: none"> <li>• It would be more difficult to get firm cost competition;</li> <li>• It would be likely to obtain less value for money as bidder risk margins will be higher; and</li> <li>• The competition would need to be run earlier which risks:</li> </ul>

Question	Response
	<ul style="list-style-type: none"> <li>o Some projects not being competed simply due to insufficient time; and</li> <li>o The process being more subject to changes in circumstances.</li> </ul> <p>In any event, the benefit of being able to compete in finding a solution/on ideas is the main advantage of an early competition, whether it is a two-stage early competition or a single-stage early competition.</p>
CSQ57. Do you consider that there are any existing examples of early competition (including international examples or examples from other sectors) which demonstrate models of early competition that could generate consumer benefit in the GB context?	<p>We have no direct experience of early stage competitions.</p> <p>We would argue that GB offshore wind is currently competed at a late stage as offshore wind developers have only to commit to price once they have obtained their consents and land rights. The price competition is through the CfD process.</p>
CSQ58. What are your views on the advantages and disadvantages of the high-level approaches to early competition outlined? How would you recommend mitigating any disadvantages?	<p><i>[see Table 15] plus subsequent wording which relates to early only [cf 8.73, 8.74]</i></p> <p>We have assumed here that a two-stage early competition is a competition for ideas followed by a late competition<sup>5</sup>. In general we think there are good reasons to adopt a two-stage process as the default model, as:</p> <ul style="list-style-type: none"> <li>• We do not agree that ideas will necessarily be more deliverable in a single stage process if the first stage of a two stage process specifically includes criteria on deliverability; an independent third party could be appointed to ensure the deliverability of the first stage preferred bidder's proposal prior to selection.</li> <li>• We do agree that competing on ideas and delivery separately should result in a lower cost and greater value for money for the UK consumer;</li> <li>• A two-stage competition may take longer, however the first stage could potentially commence earlier than a single stage competition, as the costs of the first stage would be lower than a single stage competition, and therefore the impact of having to re-run or amend the first stage would not be as significant;</li> </ul>

<sup>5</sup> See footnote 1



Question	Response
	<ul style="list-style-type: none"> <li>• We do not think total bid costs would be higher for a two-stage approach and indeed could be considerably lower as the second stage would be focussed on a known solution thus having greater certainty;</li> <li>• It would be easier to obtain cost control at the second stage of a two-stage process than in a single stage process; and</li> <li>• Risk margins would be lower at the second stage in a two stage process than in a single stage process.</li> </ul> <p>The only factor we see in favour of a single stage process, is the risk of insufficient competition in the first stage of a two-stage process in order to generate the best solutions. The level of this risk will depend in large part on how a two-stage competition is set up and the potential rewards to be gained through it for a bidder in the first stage of a two-stage competition. We would recommend that bidders are able to access meaningful (albeit proportionate) profits from providing the best solutions.</p>
<p>CSQ59. Do you have any views on the potential criteria for identifying projects for early competition discussed above? Would you suggest any other criteria, and if so, why?</p>	<p>[See Table 16]</p> <p><u>New</u> With respect to the “new” criteria we agree with Ofgem’s approach. We would recommend that it is made clear that for any solution there would not be a transfer of ownership of existing assets (above a <i>de minimus</i> level). The considerations here drive towards a two-stage competition so that only new projects are competed at the second stage.</p> <p><u>Separable</u> Again, we are supportive of Ofgem’s approach. The considerations here drive towards a two-stage competition so that only separable solutions are competed at the second stage.</p> <p><u>High Value</u> Again Ofgem has summarised the issues well.</p> <p>We would add that the definition of “high value” may also depend on whether the competition is to only reduce costs to consumers or whether there is also the scope to increase benefits to the consumer. If the latter then a consideration of the potential additional benefits of the solution should also form part of the basis for “high value”.</p>

Question	Response
<p>CSQ60. Do you agree with the criteria we have set out for assessing who should run competitions? Based on these criteria, which institution do you consider is best placed to run early and late competitions?</p>	<p>[cf 8.81 to 8.85]</p> <p>We generally agree that <i>Bias/Conflicts of interest</i> and <i>Economies of scale and scope</i> are two key criteria to be used in determining who should run competitions. In fact we would consider that the <i>Bias/Conflicts of interest</i> criteria should extend to network (owning) companies not being asked to run competitions if they, or their affiliates, are able to tender in their or indeed other competitions (due to their potential misuse of information received during a tender process). We note that Ofwat has determined that water network companies are not allowed to compete for the DPC projects they would be tendering.</p> <p>At present we believe that Ofgem is best placed to run early and late competitions, building on its experience and track record in running OFTO competitions. We could see that an independent third party, appointed by Ofgem, could also carry out the role.</p> <p>We do not see the ESO as a suitable party to run the tenders, unless and until it becomes fully independent (including in ownership terms).</p> <p>We agree that the tendering organisation needs to be <i>Proficient</i>, although we would consider that technical expertise could be contracted in.</p>
<p>CSQ64. Do you think the ESO could have a role to play in facilitating competition in the gas sectors?</p>	<p>[cf 8.101 to 8.104]</p> <p>We have no views to offer on this question at this time.</p>