

Competition in electricity transmission

Transmission Competition Policy team
Electricity Transmission
Dec 2015

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- 1. Introduction** **9.30 – 9.40**
- 2. Proposed arrangements for introducing competition in onshore transmission** **9.40 – 10.40**
- 3. Break** **10.40 – 10.55**
- 4. Panel discussion** **10.55 – 11.55**
- 5. Summary and next steps** **11.55 – 12.10**

Proposed arrangements for introducing competition in onshore transmission

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Why run competitive tenders for transmission?

Promoting effective competition

- Statutory duties

Experience from offshore transmission (OFTOs)

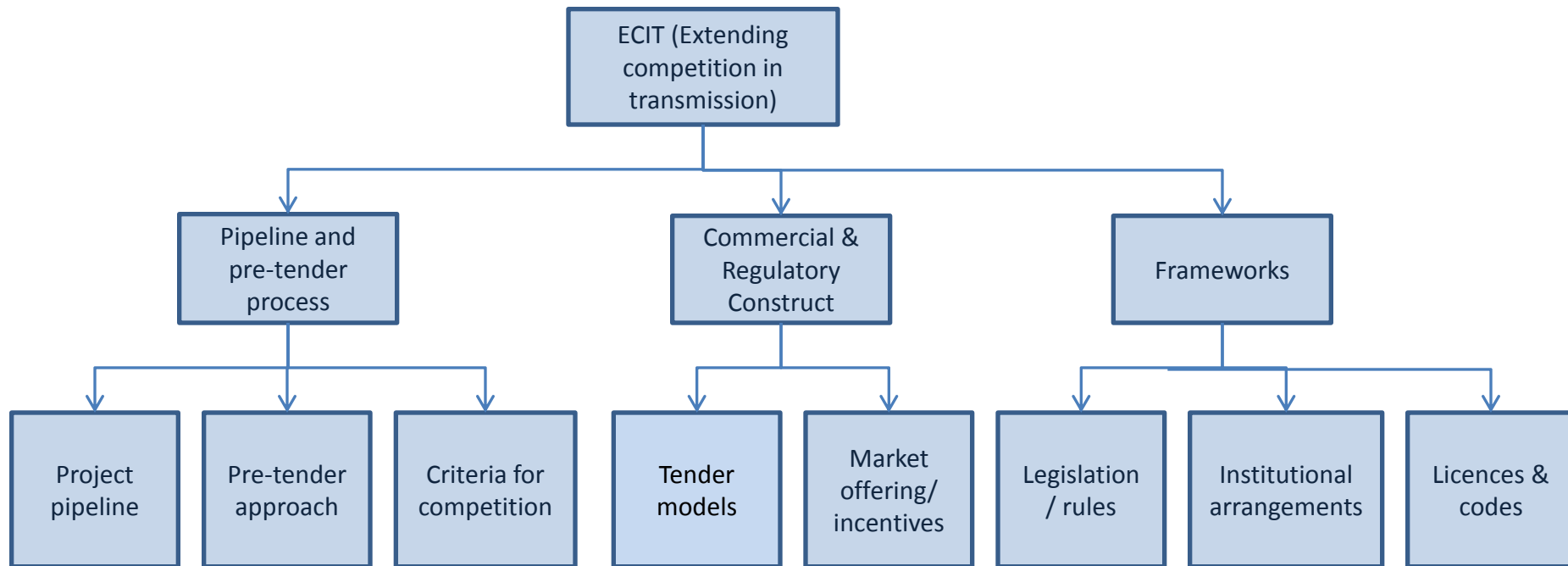
- 15 tenders so far, c.£3bn transmission investment to date
- Significant cost savings vs counterfactuals (14% from TR1)
- Further savings expected TR2
- Innovation in financing and O&M in particular



Onshore transmission - Competitively Appointed Transmission Owners (CATOs)

- Renewables, new nuclear and system reinforcement - pipeline of new large transmission infrastructure
- March 2015 – Ofgem decision that competition can be important in driving value in transmission delivery
- Competition can bring value in capital & operational cost savings. Also helps benchmarking of monopolies

Setting up the competitive regime



New

- A brand new overhead line, cable or substation, or a complete replacement of these

Separable

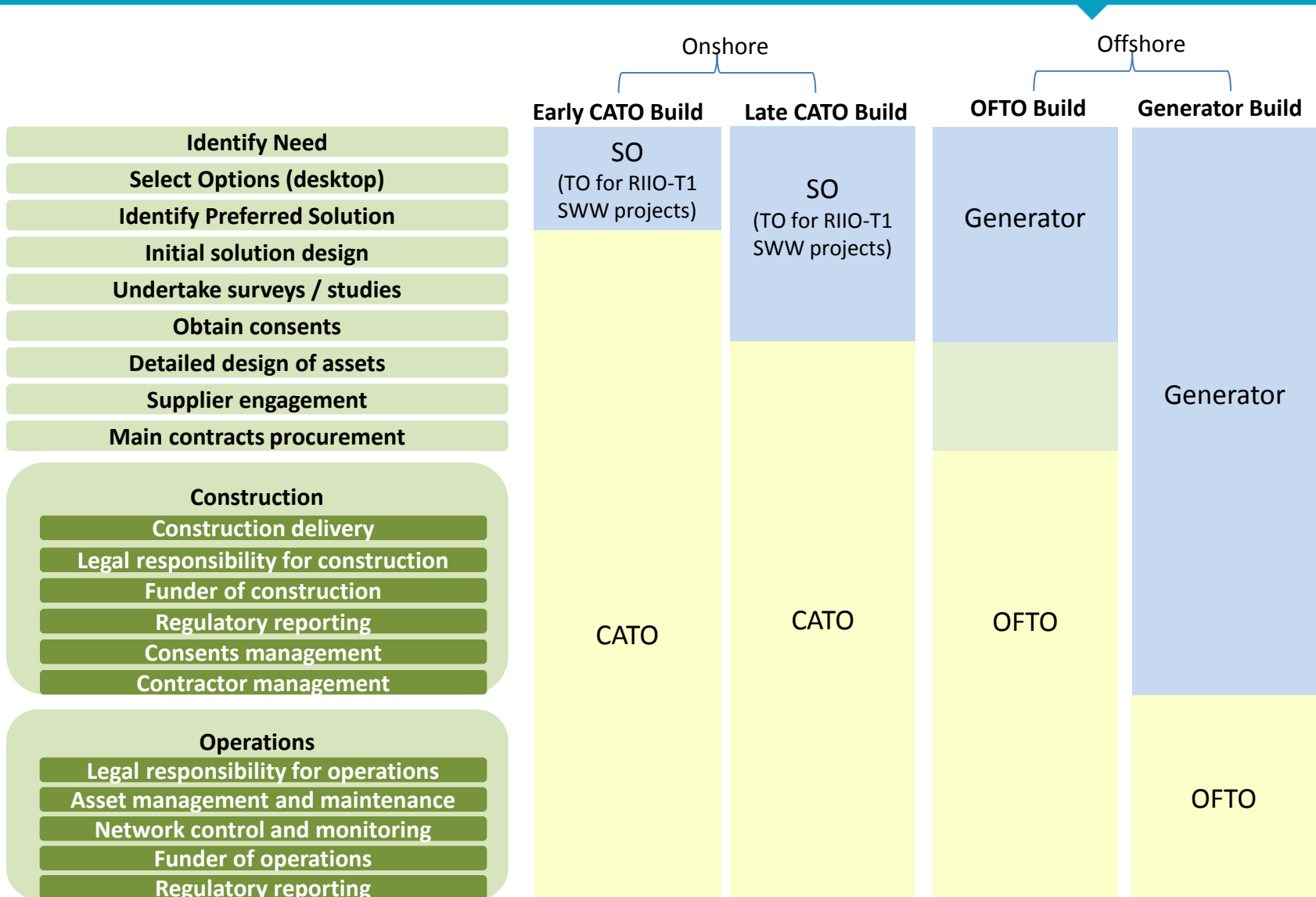
- Able to clearly delineate ownership boundaries. Not necessarily electrically separable

High-value

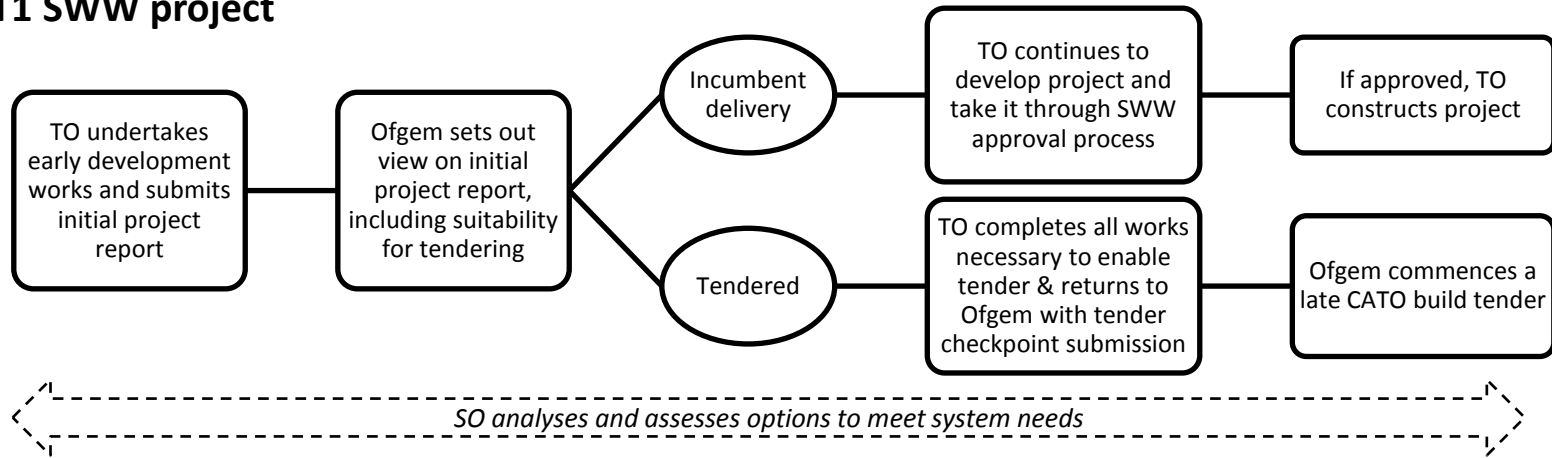
- Expected capital expenditure of £100m or more

- During RIIO-T1 (up to April 2021) only Strategic Wider Works (SWW) projects considered for tendering. Incumbents continue to deliver everything else.
- Potential pipeline:
 - New nuclear, new large scale wind generation onshore, system reinforcement
 - SO to flag future projects annually
 - For RIIO-T1 SWW – one or more projects might be tendered, but need to consider whether projects meet criteria, and timing / other delivery factors

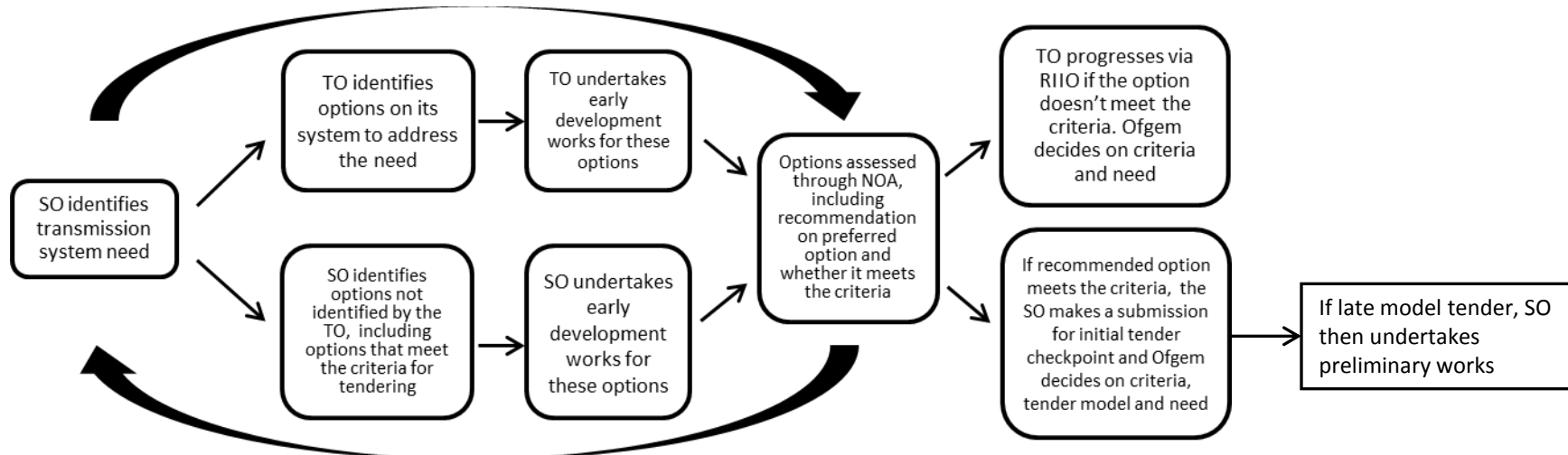
When to run a tender?



RIIO-T1 SWW project



'Enduring' project



- Preliminary works are works that need to be done before a tender can commence,
 - eg surveys, environmental impact assessments, DCO and/or section 37 consents, easements, wayleaves, etc
- We set out our proposals to oblige and incentivise the SO (or incumbent TOs) to deliver these preliminary works on time, to a high-standard and efficiently.
 - We proposed licence obligations and a 'success fee' based on either a binary or balanced scorecard approach.
- Incumbent TOs have already received funding to do preliminary works for RIIO-T1 SWW projects that they are developing.
 - They will receive further funding for any additional outputs required due to tendering.
- The SO will be funded to do preliminary works.

Tender processes and market offering

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What do we do when running tenders?

We **validate the scope** of the project and the tender specification before the tender begins.

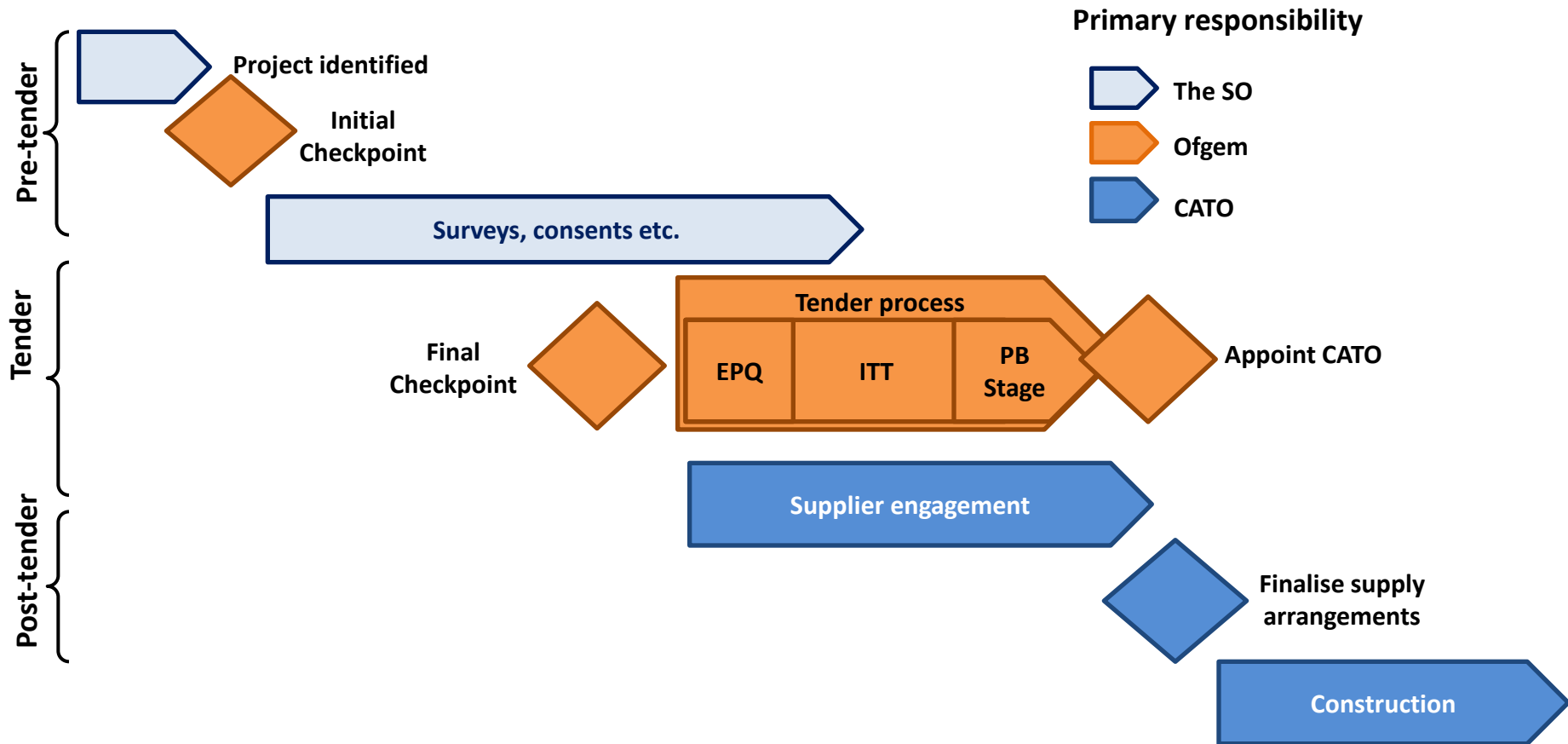
We ensure we run a **robust and fair tender process**.

We **shortlist bidders** by evaluating the bidders' technical and financial capability.

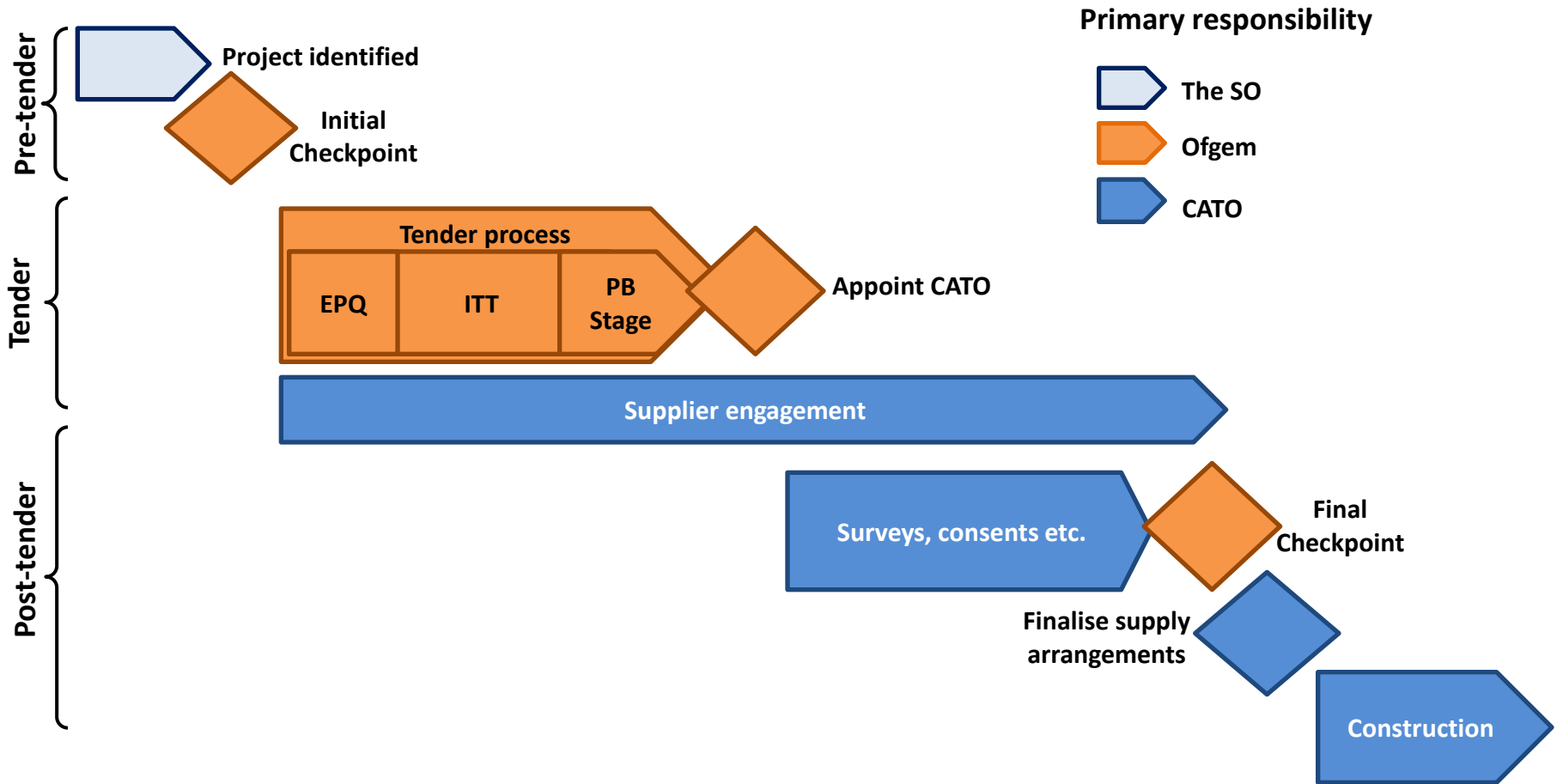
We evaluate bids at the ITT stage against criteria covering **capability/deliverability, costs** and **robustness**.

We oversee the **finalisation of arrangements** between the preferred bidder and asset owner to reach financial close.

We **protect consumers** by putting in place licence conditions that have the right balance of risks between transmission licensee and consumers.



- Tender to start once certainty over project need and outputs - some overlap with other processes (eg consenting) but prefer for ITT stage to start once consent obtained
- Tender specification likely to be quite detailed - expect CATO would have to work within tightly defined parameters (eg in planning consent)
- Prefer to fix CATO's revenue allowance before we appoint, with some limited re-openers.
 - competition would incentivise bidders to bid efficient costs so it may not be necessary or efficient to have sharing factors
 - However, open to considering other mechanisms where its not efficient to fix costs
- Revenue to commence on completion of construction



- Tender to start after NOA process has identified a preferred option – allows for innovation in design and routeing.
- More focus on design and innovation, less on supply procurement and costs during the tender process than late build
- Separate out CATO's revenue stream for preliminary works from the revenue stream for construction and operations
 - preliminary works paid during the project development period
 - main revenue stream to only start on completion of construction
- Given uncertainty in project scope and output during tender, expect bidders to bid 'best indicative cost' to construct/operate/finance:
 - Considering including specific mechanism to manage projects changes due to need or planning consent
 - CATOs to secure debt finance once all costs are known, through debt funding competition

- Propose that a **CATO's revenue should be fixed** following the tender process for as long as is economic and efficient, without periodic reviews
- Initial view is that a fixed revenue stream for **25 years** would facilitate efficient and competitive financing and allow other costs to be fixed
- Consumers should pay for all new onshore transmission assets **over the same period**. We would look to put in place incentives and obligations around **asset condition at the end of the revenue term**
- CATOs' revenue should be **indexed to an inflation index (ie CPI or RPI)**
 - proportion to be indexed should be **bid during the tender**, not set by us
- Propose that there should be a **refinancing gain share mechanism** to return a proportion of any refinancing gain during the revenue term to consumers
- If **new investment** is required on a CATO's assets during the revenue term (ie extension, new connection), **CATOs are best placed** to do the work if the project doesn't meet the criteria for tendering.
 - we would develop a mechanism to enable this

- We're considering at a high level what incentives ought to apply to CATOs
- Two of the most important areas to incentivise are:
 - **System reliability** – an availability incentive might be appropriate, possibly combined with another type of incentive (eg around asset management)
 - We think this might involve a % availability target, with a capped upside and downside of annual revenue for over- or underperformance
 - **Asset delivery** – we propose to commence a CATO's revenue on completion of construction. Not currently convinced that a specific delivery incentive would be necessary. We're keen however to understand the circumstances under which this might not be efficient
- We're considering the full range of incentives/obligations that currently apply to TOs to determine which we think are applicable to CATOs

Who can compete and next steps

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- We want to encourage as many bidders as possible
- It should be possible for the incumbent TOs to bid, so long as they put in place measures to mitigate any conflicts of interest
- NGET has conflicts of interest arising from both its TO role and its SO role – there will be a need for additional mitigations
- We set out potential conflicts and mitigations in the consultation – keen for views on these

Initial consultation on proposed arrangements

- October 2015
- Covers the commercial and regulatory construct and tender processes, also criteria and institutional arrangements
- Closes 11 January 2016

Stakeholder engagement

- Bilateral meetings with interested parties
- Events / presentations

Further consultation on our proposed arrangements

- Spring/Summer 2016
- Expect decisions in some areas where policy is more developed, further policy details in others

First tender

- From 2017
- Initial view on possible projects likely in H1 2016

Panel discussion

- Chris Veal (Transmission Investment)
- Malcolm Burns (Scottish Hydro Electric Transmission)
- Chris Bennett (National Grid Electricity Transmission)
 - Matt Cuchra (KPMG)
 - Will Lockhart (DECC)
- Alan Kelly (Scottish Power Transmission)
 - James Norman (Ofgem) - Chair

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Summary and next steps

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