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FAO: James Norman

Dear Mr Norman

**Consultation: Extending Competition in Electricity Transmission: Proposed Arrangements to Introduce Onshore Tenders**

Thank you for providing the opportunity to respond to your consultation on Competitively Appointed Transmission Owners.

Highlands and Islands Enterprise (HIE) is the Scottish Government's agency responsible for economic and community development across the North and West of Scotland and the islands.

HIE along with its local partners: the democratically elected local authorities covering the north of Scotland and the islands: Shetland Islands Council, Orkney Islands Council, Comhairle nan Eilean Siar, Highland Council, Argyll & Bute Council and Moray Council make representations to key participants on behalf of industry to influence the way in which grid construction is triggered, underwritten then accessed and charged for in the region. HIE also works closely with Scottish Government in relation to grid regulation matters and is entirely supportive of its response to this consultation.

**1. General**

HIE welcomes the introduction of competition to onshore transmission and is grateful for the opportunity to provide its views and concerns in respect of Ofgem's proposals.

Overall, HIE and its local partners welcome and agree with the key headline justifications from Ofgem in bringing forward its proposals, namely:

- Costs. A reduction in transmission costs and cost savings to the consumer.
- Competition. The introduction of both new onshore transmission owners and competitive processes for the delivery and ownership of onshore transmission.
- Transparency. Increased visibility of costs and proposal detail across a variety of organisations against any one set of onshore transmission works.

However, set against these positive headlines we have a number of concerns which are drawn out in our more detailed responses to Ofgem's questions below.

Highlands and Islands Enterprise would like to encourage Ofgem to take time to ensure that the development of competitive tendering is not progressed hastily. Highlands and Islands Enterprise does not think that the current timetable that Ofgem has set out in the consultation is therefore prudent. Ahead of progressing the

necessary legislative changes, a full consultation should be conducted to take a broader view of the opportunities, risks and justification of introducing CATOs into the market place.

## **2. Identification of projects**

HIE supports the introduction of further competition within the transmission marketplace in GB as a good principle, and is extremely keen to see reductions to the costs of transmission – and ensure, along with Ofgem, that these benefits are passed on to consumers and other transmission users alike.

Highlands and Islands Enterprise is concerned that the proposals as currently presented do not contain enough information to establish a clear view on the level of benefits that are likely to be achieved, nor to establish a complete view of the risks which will need to be considered.

### ***Strategic Wider Works under RIIO-T1***

Highlands and Islands Enterprise considers that there has been insufficient evidence presented to restrict the scope of projects only to Strategic Wider Works during RIIO-T1. Under RIIO-T1, the value threshold for Strategic Wider Works in England and Wales is £500m set against £50m and £100m in Scotland. Therefore, Ofgem's position does not best reflect the interests of consumers who stand to lose out on potential savings and benefits from a large suite of projects (valued at between £100-500m in England and Wales) that are progressed under RIIO-T1.

In practice this will not produce a level playing field as to how competitive tendering is implemented and operated across the GB system. Further, the impact of this decision is that the list of projects likely to be tendered in RIIO-T1 will be almost exclusively located in Scotland. We believe this is a significant issue that appears to disadvantage the consumer, discriminate against the Scottish transmission owners and needs to be consulted on further. It also places particular importance on ensuring that any CATO process works well in the Scottish context.

### ***Evidence of cost savings from the CATO regime***

The references to potential cost reductions are not well substantiated within the evidence provided. The evidence for potential cost savings in CATO regime comes from CEPA/BDO report regarding cost benefits of the OFTO regime. However, Highlands and Islands Enterprise notes that the CEPA/BDO report concludes that *"there are limits as the extent to which lessons can be drawn for the onshore electricity transmission network. The results are context-specific to TR1..."* and *"...caution is warranted in terms of any comparisons with the wider onshore electricity transmission regime..."*

Further, the CEPA/BDO report outlines that the savings available on financing costs (identified as a key potential benefit within the Ofgem consultation) between the OFTO regime and the price control counterfactuals are small (£8-17m net present value over 20 years, compared to £4bn capital commitment).

### ***System fragmentation***

We are concerned that fragmenting the ownership of onshore transmission will have undesirable outcomes including implications for connecting customers. When applications to connect to the transmission system are made, all affected transmission owners must assess the potential impact. Increasing the number of transmission owners will result in higher connection application fees due to the

increase in the number of parties that are required to be consulted and assess network impacts. Further, the standard three month process to make a connection offer is likely to be inadequate.

#### ***Impact on delivery timescales***

We are aware that Scottish Government has provided detailed comments in its response in relation to the differences in planning and consenting in Scotland compared to England and Wales. Given these differences, we share Scottish Government's view that the CATO process is likely to increase overall project delivery timescales for Scotland, and also shares its concern about the impact on key Strategic Wider Works projects. In particular, we are concerned that the CATO process will introduce delays into the process of delivering transmission reinforcements that have a clear and justified need. This concern relates specifically to Strategic Wider Works currently identified, including connections to the Western Isles, Shetland and the east coast reinforcements (Beaulieu to Blackhillock and Blackhillock to Kintore).

The islands connections specifically are at an advanced stage awaiting final needs case assessments. The works will still take a relatively long time to deliver once the needs case is approved and the generation projects that are both driving and reliant on them must have timely delivery for Contracts for Difference purposes. In addition, consumers and other users on these island groups will benefit substantially from the island links seeing an uplift in security of supply, local employment opportunities, and a wider socio-economic uplift. No delay or undue risk of delay to delivery of these works can be accepted.

We welcome and fully support the commitment by Ofgem to take into consideration – alongside the criteria for tendering – the potential for tendering to impact negatively upon deliverability and *“will not tender those projects if there would be a material adverse impact on the project, including on timing.”*

It is not clear from the consultation document how those projects will be identified and the weight attached to such concerns. This requires to be clarified urgently.

#### ***Role of System Operator (SO)***

It is essential that the SO role is adequately resourced and staffed to ensure it has the capacity and ability to undertake more than a simple management role. Again, we concur with Scottish Government's views that the SO should drive the programme forward and is appropriately empowered to do so. It is also critical that the SO fully and appropriately liaises with Scottish Government and Scottish regulatory bodies.

### **3. Tender process and market offering**

#### ***O&M innovation – reduction in operational expenditure (opex)***

We support increased scrutiny and testing of current operation and maintenance (O&M) practices of incumbent transmission owners to ensure that these are optimised and efficient. However, we note that one of the key benefits identified within the consultation is innovative approaches to O&M of assets to reduce opex.

We do not believe that this has been substantiated within the evidence provided, nor any detail given on how this is expected to be achieved. Further, Ofgem has outlined that one of the reasons that *“new, separable and high value”* works are good



candidates for competition is due to the “*relatively low opex.*” Therefore, it seems that the potential benefits of lowered opex are marginal.

Further, it is not clear from the consultation how the introduction of competition will more effectively drive innovation compared to the current mechanisms for incentivising innovation at transmission. We are also concerned that technical ‘innovation’ introduced through CATOs may come at the expense of network performance, maintenance and security of supply. We do not believe that the lowest opex cost (for only a proportion of the lifespan of tendered assets) should be the overall objective – the assessment should instead be focused on ‘appropriate costs’.

#### ***System design innovation***

We consider that there needs to be an exploration of the current standards used and practices adopted by transmission owners to ensure that the current industry wide standards are fit for purpose in the context of introducing new transmission owners.

#### ***Financial innovation***

We understand that potential financial innovation is available by the introduction of new market entrants. However, we are concerned that the market offering developed by Ofgem in order to attract investment may decrease system security by limiting operational risk to CATOs, potentially resulting in a net dis-benefit to consumers. The increased operational risk passed to the consumer is discussed above.

#### ***Revenue term***

The consultation does not present sufficient evidence to support the proposed 25 year revenue period. The consultation notes that the proposed term is best suited for access to finance, but there does not appear to be any consideration of the potential impact of this policy implementation on the operation of the transmission system.

#### ***Security of supply and fragmentation***

We have significant reservations about the proposed financial incentives for CATOs, and consider that they may present a threat to system security, reliability, coordination and deliverability. We are of the view that simply incentivising availability will not result in a system that has sufficient flexibility to ensure efficient operation and development, as the parties required to coordinate outages (system operator and transmission owners) will be more numerous and have divergent commercial drivers as a result of the regulatory misalignment.

### **4. Managing conflicts of interest**

We believe that the risks posed by the conflict of interests that have been identified by Ofgem within the consultation are significant. Further, we are concerned that there is currently no clear understanding, presented within the consultation, of the potential impact on incumbent transmission owners/system operator behaviour as a result of introducing the CATO process.

To date, Ofgem has presented no detail on how conflicts of interest will be managed and it is very hard to see how this issue can effectively be tackled within the current industry regulatory regime and structures.

We look forward to seeing the results of this consultation in due course.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Elaine Hanton'.

Elaine Hanton  
Joint Head of Energy

In partnership with:  
Shetland Islands Council  
Orkney Islands Council  
Comhairle nan Eilean Siar  
Highland Council  
Argyll & Bute Council

