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Extending competition in electricity transmission: criteria, pre-tender and conflict mitigation arrangements

Consultation

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Overview:

This document represents the next step to introduce competitive tendering to onshore electricity transmission. Following our assessment of the responses to our last consultation in October 2015, we present here our decisions on specific policy areas, as well as updated proposals, for consultation, on other areas.

The focus of this document is on the criteria and process for identifying when a competitive tender can be run, the pre-tender arrangements under a late competitively appointed transmission owner (CATO) build tender model, and our proposals for conflict mitigation measures. This document focuses mainly on developing the more immediate arrangements needed to set up the new competitive regime for any projects tendered during RIIO-T1.

Alongside this, we have published a summary of responses to our October consultation, an independent report from consultants, which considers what would be required for a tender specification under a late CATO build tender model, and our updated impact assessment.

We intend to publish further details on the regime within the next few months, including specifically consulting on how we will run tenders and the market offering for a CATO.

This document is aimed at parties interested in the competitive regime, including potential bidders, incumbent network operators, interested consumer groups, as well as other relevant stakeholders.

Context

Great Britain's onshore electricity transmission network is currently planned, constructed, owned and operated by three transmission owners (TOs): National Grid Electricity Transmission (NGET) in England and Wales, SP Transmission in the south of Scotland, and SHE Transmission in the north of Scotland. We regulate these TOs through the RIIO (Revenue = Incentives + Innovation + Outputs) price control framework. For offshore transmission, we appoint TOs using competitive tenders.

The incumbent TOs onshore are currently regulated under the RIIO-T1 price control, which runs for 8 years until 2021. Under this price control, we developed a mechanism for managing the assessment of large and uncertain projects called 'Strategic Wider Works' (SWW). The incumbent TOs are funded to complete 'pre-construction' works, and then subsequently follow up with applications for construction funding when the need and costs for the project solidify. As part of our decision on the RIIO-T1 price control, we set out that projects brought to us under the SWW regime could be subject to competitive tendering.

We previously undertook the Integrated Transmission Planning and Regulation (ITPR) project, which reviewed the arrangements for planning and delivering the onshore, offshore and cross-border electricity transmission networks in GB. Through the ITPR project, we decided to enhance the role of the system operator (SO) to play an increased role in identifying the long term needs of the system and to develop and assess options to meet those needs. In September 2015 we set out our decision to change the SO's and onshore TOs' licences to give effect to these roles. We also decided through the ITPR project to increase the role of competitive tendering where it can bring value to consumers. In particular, we decided to extend the use of competitive tendering to onshore transmission assets that are new, separable and high value. As part of our Final Conclusions, we included our assessment of the impact of introducing competitive tendering onshore.

Following the ITPR project, we set up our Extending Competition in Transmission (ECIT) project to implement competition in onshore electricity transmission. We published a consultation on our proposed arrangements for competitive onshore tendering in October 2015. We are now further developing this competitive onshore regime, with a view to being ready to run competitive tenders from mid to late 2017.

Associated documents

Extending competition in electricity transmission: arrangements to introduce onshore tenders, October 2015
https://www.ofgem.gov.uk/publications-and-updates/extending-competition-electricity-transmission-proposed-arrangements-introduce-onshore-tenders

Criteria for onshore transmission competitive tendering, May 2015
https://www.ofgem.gov.uk/publications-and-updates/criteria-onshore-transmission-competitive-tendering

Integrated Transmission Planning and Regulation project: Final Conclusions, March 2015
https://www.ofgem.gov.uk/publications-and-updates/integrated-transmission-planning-and-regulation-itpr-project-final-conclusions

Contents

Executive Summary

In our Final Proposals for RIIO-T1,[1] we indicated that Strategic Wider Works (SWW) projects to be constructed during the price control period could be subject to competitive tendering.

Following further policy development, under our Integrated Transmission Planning and Regulation (ITPR) project, we committed to introducing competitive tendering for new, separable and high value onshore electricity transmission assets.

We are now developing the detailed arrangements to implement this policy and consulted on our initial proposals for the regime in October 2015. This document sets out further detail on several key elements of these arrangements:

- an overview of our **indicative work programme** for introducing competition into onshore transmission and how this relates to other work being undertaken in electricity transmission (eg the Network Options Assessment (NOA) and the review of the role of the system operator (SO)). We aim to be in a position to run competitive tenders from mid to late 2017.

- **what we'll competitively tender** – our decision on the definitions of the criteria for determining what is tendered and the process for identifying future projects.[2]

- **what will happen before a tender** – further proposals on roles, funding and incentives for pre-tender activities to be undertaken by a transmission owner (TO) before any late competitively appointed transmission owner (CATO) build tender for a project to be delivered during RIIO-T1.

- **how to ensure a level playing field** – our proposed measures for mitigating conflicts of interest for any projects tendered during RIIO-T1, focusing mainly on measures to be taken forward by TOs.

This document focuses mainly on developing the more immediate arrangements needed to set up the new competitive regime for any projects tendered during RIIO-T1. Given the focus on RIIO-T1, we have concentrated on arrangements under the late CATO build tender model, where the incumbent TO would carry out the necessary preliminary works for a project, ahead of a tender to identify a CATO to construct, own and operate the assets. We focus on late CATO build because any SWW projects tendered during RIIO-T1 have already been developed and progressed

[1] RIIO-T1 is the current price control period for the three electricity transmission owners (TOs) (and the system operator (SO)) in GB. The period runs from 1 April 2013 to 31 March 2021.
[2] Those projects which do not meet the criteria for tendering will continue to be delivered by the relevant incumbent TO.

by the incumbent TOs and the TOs have been funded for pre-construction activities through the price control.

We also set out a direction of travel for what the arrangements in the above areas might be for a project to be constructed during RIIO-T2.[3] We will consult on the detailed arrangements for RIIO-T2 at a later stage.

We also publish (accompanying this document) our updated impact assessment on the introduction of competitive tendering for onshore transmission. Our updated impact assessment continues to support our view that there is a strong case for introducing competitive tendering for onshore transmission assets which are new, separable and high value.

What we'll competitively tender

We define the criteria for determining what is tendered as:

- **New** – completely new transmission assets or complete replacement of transmission assets.
- **Separable** – ownership between these assets and other (existing) assets can be clearly delineated.
- **High value** – at or above £100m in value of the expected capital expenditure of the project.

We anticipate reviewing these criteria periodically to ensure they are still appropriate. We also provide additional clarity on how to define a project, how assets could be packaged together in a project for the purposes of a tender, and what is in and out of scope for tendering.

Finally, we set out a clear process for project identification, assessment against the criteria and how we will make decisions on tendering projects. For RIIO-T1 projects, where incumbent TOs have already undertaken significant pre-construction work, we set out that our considerations around tendering are likely to include delivery timing, transferability of works and the value of potential savings to consumers.

[3] RIIO-T2 will run from 2021 to 2029.

What will happen before a tender

This document sets out our view that where we decide to tender a project during RIIO-T1, the incumbent TO should undertake preliminary works and tender support activities in order to facilitate an efficient tender process.

Tender support activities include responding to bidder due diligence enquiries, preparing a virtual data room and preparing a 'baseline tender specification'. We give details of, and invite views on, the proposed content of the tender specification and outline how this would relate to the preliminary works.

We propose to fund a TO for the efficient costs of additional activities associated with the tender that have not already been funded as pre-construction works under RIIO-T1. We propose that the level of funding would be determined during the tender period, on an ex post basis, and would be paid for by the CATO.

TOs are responsible for developing an efficient, coordinated and economic system of electricity transmission within their licenced area. As such, and given the additional licence obligations and funding referred to above, we expect TOs to undertake preliminary works and tender support activities in a timely manner and to a high standard which promotes an efficient tender and the best outcome for consumers.

How to ensure a level playing field

We are committed to ensuring that there is a level playing field for all bidders participating in a competitive tender for onshore transmission. In this document we put forward more detailed proposals for how conflicts of interest can be managed.

During RIIO-T1 where a TO is both developing the preliminary works for a late CATO build tender model, and intends to bid on that project, we propose a package of obligations on conduct, business separation measures and scrutiny to address conflicts of interest. These separation measures relate to information, managerial, employee, physical, financial and legal separation.

For other bidders (ie not incumbent TOs), we propose to adopt similar practices to those we use for our offshore transmission owner (OFTO) tenders, where we seek clarity on potential conflicts, assess separation measures and require the bidder to provide various undertakings.

We are considering the most appropriate mitigations for conflicts of interest relating to the SO's role in competition as part of our wider consideration of the future SO role and structure. We will consult on this further at a later date.

Next steps

We intend to consult in further detail on the tender models and market offering (ie revenue stream, incentives etc) for CATOs in the summer. We will need to make modifications to the TOs' licences in order to give effect to many of the arrangements

set out in this document. We intend to progress these licence modifications over the summer, ahead of consultation, including through the use of licence drafting working groups.

We expect later this year to publish and consult on further details around the SO role and separation of National Grid Electricity Transmission's (NGET's) SO and TO businesses, before taking forward relevant modifications to the SO's licence.

We currently expect to consult, by late 2016, on whether a potential RIIO-T1 SWW project to connect Nugen's proposed nuclear station in Moorside, Cumbria, is suitable for tendering. For an indicative view of potential projects coming forward, please refer to our website for SWW projects,[4] and the SO's NOA report[5] which presents a 10-year outlook for significant projects.

[4] https://www.ofgem.gov.uk/electricity/transmission-networks/critical-investments/strategic-wider-works
[5] http://www2.nationalgrid.com/UK/Industry-information/Future-of-Energy/Network-Options-Assessment/

1. Overview

Chapter summary

This chapter sets out the scope of this document and provides an update on our work on Extending Competition in Transmission (ECIT).

Context

1.1. We have previously set out our decision,[6] through our Integrated Transmission Planning and Regulation (ITPR) project, to introduce competitive tendering for onshore electricity transmission assets that are new, separable and high value. This builds on our statutory duties and corporate strategy, which identify that competition should be used where it can achieve positive outcomes for consumers. For RIIO-T1, we also set out that only Strategic Wider Works (SWW) projects would be considered for tendering. For the avoidance of doubt, we will not consider running a tender in relation to an SWW project where we have already set an output and allowances for that project's construction.

1.2. We published a consultation on our proposed high level arrangements for competitive onshore tendering in October 2015 (our 'October consultation').[7] We have since further developed these arrangements.

1.3. Our October consultation set out our proposals for tender models, roles of parties under these models, the criteria and process for identifying when a competitive tender could be run, pre-tender arrangements, and revenue and incentive proposals for competitively appointed transmission owners (CATOs). It also included high level proposals for mitigating conflicts of interest which could result from the introduction of competition, particularly where existing parties participate in the competition. We received 35 non-confidential responses to our consultation, which closed in January 2016. These responses are available on our website, alongside the consultation.[8]

1.4. We previously set out two models for tendering, a late model and an early model. Under the late model ('late CATO build') a tender would determine a party

[6] Integrated Transmission Planning and Regulation (ITPR) project: Final Conclusions, March 2015: https://www.ofgem.gov.uk/publications-and-updates/integrated-transmission-planning-and-regulation-itpr-project-final-conclusions

[7] Extending competition in electricity transmission: arrangements to introduce onshore tenders, October 2015: https://www.ofgem.gov.uk/publications-and-updates/extending-competition-electricity-transmission-proposed-arrangements-introduce-onshore-tenders

[8] We have also included a summary of responses, which is supplementary to this consultation.

(the CATO) to construct, own and operate the asset, after completion of the preliminary works (eg early design, consenting) for the project. Under the early model ('early CATO build') a tender would commence earlier in the project development process, to appoint a CATO to carry out the preliminary works, as well as construct, own and operate the asset.

How we're structuring our ECIT work

1.5. We intend to issue a decision on any outstanding policy proposals from this consultation in the autumn, together with a consultation on licence modifications to implement these arrangements.

1.6. We aim to be in a position to run the first competitive tender for onshore transmission from mid to late 2017, although (as set out later) this timescale is subject to primary and secondary legislation being in force, and to projects coming forward that meet our criteria for tendering.

1.7. Figure 1 and Figure 2 provide an overview of our indicative work programme for introducing competition into onshore transmission through our ECIT project. We have included an overview of our indicative work programme to develop our policies for both the RIIO-T1 period (2013-2021) and for the RIIO-T2 period (2021-2029). Whilst these are the defined price control periods, where we differentiate between these price controls, in the context of project development, we are referring to the period in which project construction would commence, ie if a project would begin preliminary works in RIIO-T1, but commence construction in RIIO-T2, we refer to this as relating to RIIO-T2.

1.8. The focus of most of our current work, and of most of this document, is on developing the arrangements for the RIIO-T1 period in some detail. This is because it is important to be clear on the arrangements that would apply should we tender any SWW projects during the RIIO-T1 period. This document therefore focuses more on arrangements that would apply under late CATO build, as any SWW projects tendered during RIIO-T1 have already been developed and progressed by the incumbent transmission owners (TOs), and the TOs have been funded for pre-construction activities through the price control.

1.9. Beyond RIIO-T1, the nature and number of projects that might come forward for tendering is currently developing, as is the future role of the system operator (SO). However, we consider that there is value in providing some visibility about the early direction of our policy beyond RIIO-T1, ahead of future consultation.

Figure 1: Indicative ECIT timings for RIIO-T1 policy development

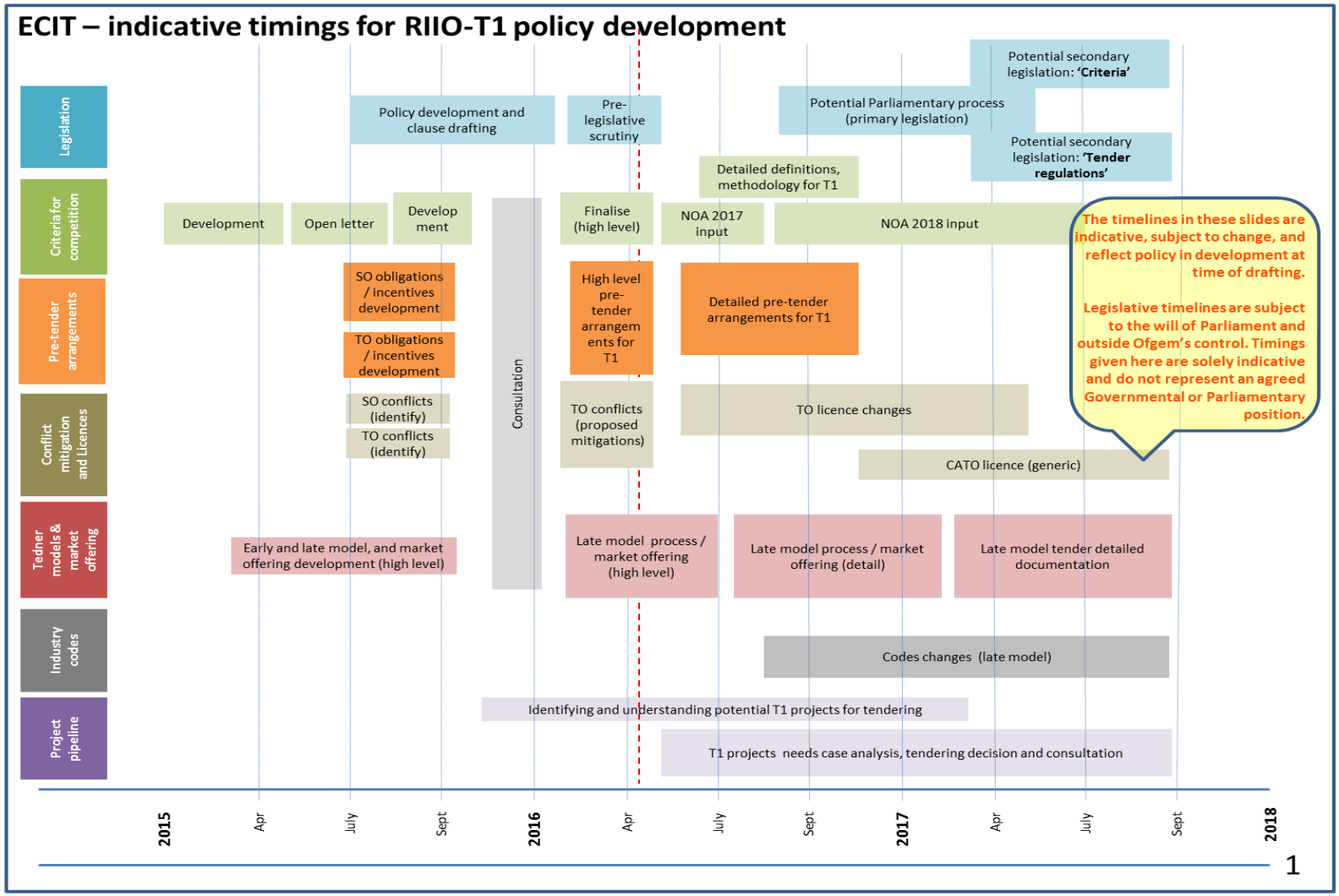
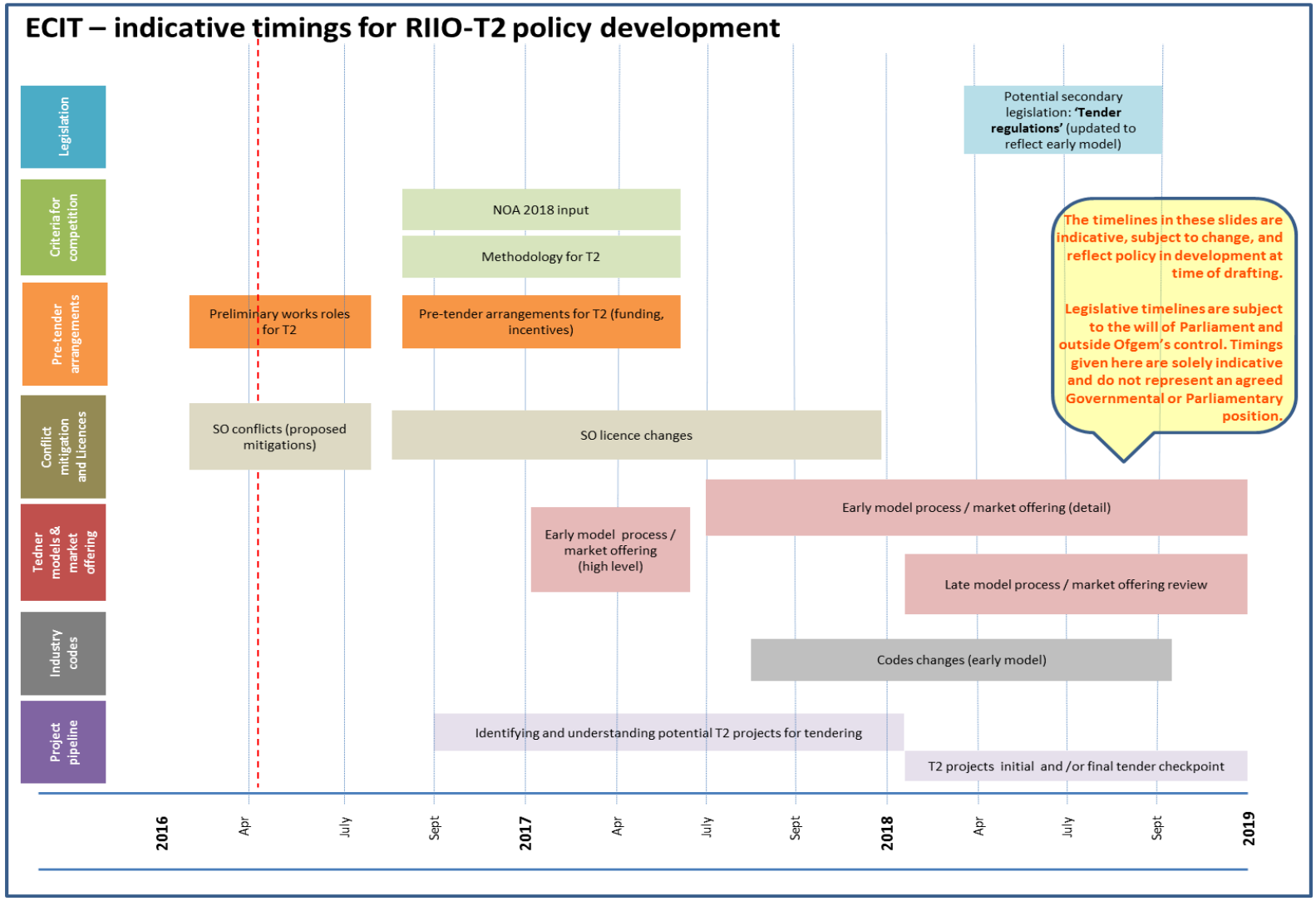


Figure 2: Indicative ECIT timings for RIIO-T2 policy development



1.10. As noted in Figures 1 and 2, timescales are indicative as legislative timelines are outside of our control – any changes to those timelines may impact on our plans for other areas of work.

1.11. We have been, and will continue to work with relevant stakeholders to develop the regime, across each of the workstreams shown. For example, we are working closely with Government to design the necessary legislative framework, and have created (in association with the Energy Networks Association and its members) an industry steering group for the project, along with associated working groups. We will publish any relevant findings and deliverables from those groups, which should inform our ongoing development of the regime.

1.12. We set out below further information on each of the workstreams shown in Figures 1 and 2.

Legislation

1.13. DECC published draft (primary) legislation[9] to facilitate competition in onshore electricity transmission networks, for pre-legislative scrutiny. We expect this to be implemented through both primary and secondary legislation. The draft primary legislation would enable us to run competitions for 'relevant licences'. A relevant licence is, broadly, (a) an offshore transmission licence, (b) a transmission licence (other than an offshore transmission licence) which regulates assets which meet criteria that will be set out in secondary legislation made by the Secretary of State (SoS) and subject to Parliamentary process, or (c) a distribution licence which regulates assets which meet relevant criteria, set out in secondary legislation.[10] We consider that this would give the onshore competitive regime an appropriate form of legal underpinning and would provide long term certainty for investors and clarity for tender participants including bidders, existing transmission licensees and other stakeholders.

1.14. The Energy and Climate Change Committee (ECCC) recently undertook a process of pre-legislative scrutiny of the draft legislation. In its report[11] the ECCC made a number of recommendations for the draft legislation. The key relevant recommendations for this document included: amending the legislation to direct us to introduce impact assessments for project-specific tendering decisions, asking for clarification on what exactly we will be doing to mitigate against the risk of delaying projects that are subject to tendering, as well as requesting that the Government set out in this or other relevant legislation how potential delays to late CATO build

[9] https://www.gov.uk/government/publications/draft-legislation-on-energy
[10] We do not propose to commence any legislative provisions during the current RIIO-ED1 price control. Any plans to do so in future would require further policy development and consultation.
[11] House of Commons Energy and Climate Change Committee (2016), pre-legislative scrutiny of the Government's draft legislation on energy: http://www.publications.parliament.uk/pa/cm201516/cmselect/cmenergy/776/776.pdf

projects due to Scotland's planning regime will be overcome. We are working with Government to consider these recommendations. Where relevant, we have included our view on these recommendations in this document. Some of these recommendations will be discussed further in our consultation in the summer on tender models and market offering.

1.15. We currently expect to support Government to develop secondary legislation – as indicated in Figure 1. We currently expect that the secondary legislation defining the new, separable and high value criteria will be subject to Parliamentary scrutiny and thus the criteria cannot be considered to be settled until that process is complete. In parallel we expect to develop secondary legislation, 'Tender Regulations', setting out the arrangements we would use to run competitive tenders onshore.

1.16. This legislation would support both the regime for RIIO-T1, but also the enduring regime beyond this.

Criteria for competition

1.17. We are developing robust criteria which will determine whether an onshore electricity transmission project is suitable for competitive tendering. These are intended to capture projects for which we consider the benefits of competition significantly outweigh any potential costs/risks.

1.18. We are also developing the process for identifying assets that meet the criteria and for making decisions on whether to tender these assets. For further details see Chapter 2.

Network Options Assessment

1.19. As part of the ITPR Final Conclusions, we decided to introduce the Network Options Assessment (NOA) process for system planning. We set out that part of the SO's role in this process would be to assess the suitability of transmission options for tendering, and to make recommendations on this. We also set out that the SO would lead certain non-TO delivered options and undertake early development works for these.

1.20. The first NOA report was published in March 2016.[12] We are engaging with the SO and wider stakeholders to make changes to the NOA process and methodology, to deliver the originally identified goals arising from the ITPR Final Conclusions. In particular, this includes incorporating changes to support the competitive regime.

[12] http://www2.nationalgrid.com/UK/Industry-information/Future-of-Energy/Network-Options-Assessment/

1.21. We expect that this will be an iterative process. It is our view that by 2018, the NOA process should have incorporated all the changes necessary to deliver both the enhanced SO role arising from ITPR, as well as the additional changes necessary to support competition. Although it is likely that the NOA report in 2017 will represent an interim step towards this, we are keen for this to incorporate as many changes as feasible.

1.22. By 2018 we therefore consider that the NOA methodology will need to be updated to incorporate more stringent information requirements, an assessment of options against the criteria with an accompanying recommendation on suitability for tendering, further project identification principles, as well as to enshrine the role for the SO in undertaking early development works for SO-led options. For further details on the NOA see Chapter 2.

1.23. We expect that we may need to amend the SO's relevant licence conditions to implement these specific changes. Implementation of licence amendments is discussed further below.

Pre-tender arrangements

1.24. Under late CATO build during RIIO-T1, the incumbent TO will be responsible for undertaking the necessary preliminary works and tender support to develop a project ahead of a tender.

1.25. We are developing the framework for these pre-tender roles, including the relevant obligations, incentives and funding arrangements. For further details see Chapter 3. We have further developed these arrangements for TOs given these will be required sooner.

1.26. We set out in our October consultation, that the SO would carry out the preliminary works and tender support role for RIIO-T2. We are working closely with DECC on whether there is a case for further separation of the SO, looking not just at the SO role in onshore competition, but across all its activities. In parallel, we are considering the appropriate arrangements for the SO Incentives framework to apply once the current scheme ends (31 March 2017).

1.27. We think that putting in place the right roles, incentives and obligations for the SO in relation to competitive onshore tendering is important, but must be considered in the context of the wider role being considered for the SO. Most of the roles, incentives and obligations for the SO in relation to onshore competition would apply during the RIIO-T2 period, with the exception of the NOA changes, as highlighted above.

1.28. As such, we expect to publish and consult at a later date on further details around the SO role, separation between the SO and TO parts of National Grid Electricity Transmission (NGET) and developments for the SO Incentives framework.

Conflict mitigation and licences

1.29. We believe that, under the new competitive regime, conflicts of interest could arise from the roles of the SO and existing TOs in relation to tendered projects, or from other bidders with knowledge of a project. We are developing a range of measures to mitigate these, to prevent parties from gaining an unfair competitive advantage. Further information is included in Chapter 4. Conflict mitigation measures for the SO will be covered within our future publication referred to above on the wider SO role.

Licence amendments

1.30. We intend to implement the revised roles and obligations on the SO and TOs under onshore competition through modifications to their licences. We expect these modifications to relate to changes to the current NOA arrangements, the introduction of pre-tender arrangements, and conflict mitigation measures. We will consult on any proposed modifications to the relevant licences.

1.31. We intend to progress proposals for TO licence modifications as a priority following the consultation on this document to ensure we create a robust, fair and transparent regime for any tendered RIIO-T1 projects. We will initiate this process during the summer, including through licence drafting working groups.

1.32. We expect that SO licence modifications to support onshore competition will be linked to our wider work on the future SO role. Subject to further consultation, we envisage starting this work on wider SO licence changes next year with a view to implementation by late 2017 or early 2018.

Tender models and market offering

1.33. As set out in our October consultation, we intend to develop detailed tender processes and arrangements for both late CATO build and early CATO build. We are also developing the market offering for a winning CATO bidder, including details of the revenue stream, incentives, and allocation of risk.

1.34. It is our intention to consult in more detail on late CATO build and the associated market offering in the summer. We also intend in that document to provide more detail on how we think tendering under the late CATO build model will interact with planning processes in England, Scotland and Wales, including the transfer of planning consents and land rights.

1.35. We intend to work closely with our industry groups to develop the early CATO build model further, over the rest of this year, with a view to consulting further on early CATO build in early 2017.

Industry codes

1.36. We expect we will also need to review and make changes to various industry codes, to incorporate the inclusion of new parties (CATOs).

1.37. We expect to consider this work further with industry over the coming months and consult further on our proposals in due course.

Project pipeline and assessment

1.38. Many stakeholders have been interested in understanding the pipeline of potential projects which could be suitable for tendering. This pipeline is dependent on the firm need for projects, which is driven by the background generation and demand, coming on to the system. We're keen to provide stakeholders with transparency around the potential pipeline, as this is important to ensure interested parties have time to prepare and get the most from the competitive market.

1.39. As set out previously, for RIIO-T1, we have previously decided that we will only consider running a competitive tender in the case of SWW projects. SWW projects are identified in the TOs' licences[13] as: projects that meet the relevant value threshold and reinforce or extend the National Electricity Transmission System to meet existing and future customer requirements; the reinforcement will provide additional transmission capacity and/or boundary transfer capability.

1.40. Previously, TOs have brought the needs cases for SWW projects to us once the background need for those projects was firm. We have a process in place to assess the need for those SWW projects ahead of assessing the efficiency of project details and costs. In future, TOs will bring forward the needs case for projects earlier, when they are narrowing down options ahead of planning applications – as part of an 'initial needs case' (INC). The need for the project will then be confirmed as part of a 'final needs case' (FNC) assessment. As part of this needs case process, we will also assess the suitability of those projects for competition.

1.41. We set out in our October consultation that beyond the new, separable and high value criteria, during RIIO-T1, there may also be other relevant factors which we will need to consider in assessing whether to run a competitive tender for a particular project. We set out further details on these factors and the process we will use for deciding whether to run a tender in Chapter 2.

1.42. We currently expect to consult, by late 2016, on whether a potential RIIO-T1 SWW project to connect Nugen's proposed nuclear station in Moorside, Cumbria, is

[13] https://epr.ofgem.gov.uk/Document

suitable for tendering. For an indicative view of potential projects coming forwards, please refer to our website for SWW projects.[14]

1.43. We will tender any project that meets the criteria in RIIO-T2, ie we will not limit tendering to SWW projects. We currently have less visibility of the future RIIO-T2 project pipeline. Our best view of projects is driven by the NOA,[15] which provides a 10-year outlook on potential transmission options. We expect the next NOA report to be published in January 2017. We are working with the SO to update the NOA, as set out earlier in this chapter, and are also working with them to develop the processes for identifying projects, outside of the NOA process, that might be suitable for tendering in RIIO-T2, eg generator connections.

Scope of this document

1.44. Following our October consultation, and assessment of responses, we present in this document decisions for specific policy areas, and consult on updated proposals for others. Where we are seeking your views on proposals, we have included consultation questions in the relevant chapters.

1.45. This document covers:

- Criteria for competition (Chapter 2) – our decision on the definitions of the criteria; our proposals for the process for project identification; as well as our proposals for principles for project packaging and asset transfer.

- Pre-tender arrangements (Chapter 3) – further proposals on roles, funding and incentives for pre-tender activities under late CATO build during RIIO-T1, including high level considerations for RIIO-T2.

- Conflict mitigation arrangements (Chapter 4) – proposed measures for conflict mitigation during RIIO-T1, focused mainly on TO conflicts.

1.46. Several sections of the document are applicable across both late CATO build and early CATO build, in particular Chapter 2 (criteria for competition). Our updated impact assessment (see below) also considers both early CATO build and late CATO build. We intend to publish further details in due course on how the competitive regime will work during RIIO-T2, for both early CATO build and late CATO build.

[14] https://www.ofgem.gov.uk/electricity/transmission-networks/critical-investments/strategic-wider-works https://www.ofgem.gov.uk/electricity/transmission-networks/critical-investments/strategic-wider-works
[15] http://www2.nationalgrid.com/UK/Industry-information/Future-of-Energy/Network-Options-Assessment/

Supplementary documents

1.47. Alongside this document, we have published several supplementary documents – these are available on our website. These include:

- A summary of responses to our October consultation – key views raised by stakeholders. Our responses to the key points raised are included in the main document.

- An external consultant's report on the basis for a tender specification under late CATO build. We commissioned TNEI and Pöyry to produce a report on the information that bidders would require in a late CATO build tender specification and data room. The report represents an independent view which we will consider carefully in developing our policy.

- An updated impact assessment – we have updated our impact assessment, which we published alongside the ITPR Final Conclusions in March 2015. We consider that updating our impact assessment is best practice, given the additional information (eg cost information) we have had access to since March 2015. We have also considered some specific points raised by stakeholders in our last consultation, which were relevant to our assessment of the impacts of introducing competitive tendering onshore. We conclude through our impact assessment that there is still a strong case for introducing competitive tendering for onshore transmission assets which are new, separable and high value.

2. Criteria for competition

Chapter summary

This chapter sets out details on the criteria we will apply for assessing which projects will be tendered. It also sets out the process for identifying these projects.

Question box

Question 1: What are your views on our proposed arrangements for asset ownership and responsibilities? In particular can you provide examples of specific scenarios where it may be necessary for ownership transfer of existing physical assets to occur between network operators?

Question 2: Do you agree with our proposed principles for packaging projects?

Question 3: Do you consider the processes we have set out for determining which projects to tender are appropriate?

Question 4: Beyond the NOA and the connections process, what other routes should we be utilising to identify suitable projects for competition, eg for non-load projects?

Question 5: What do you consider should constitute 'early development works' for options ahead of their assessment in the NOA process, ie what works should be undertaken in order to ensure that the most appropriate tendered options are developed for submission at the initial tender checkpoint?

Context

2.1. We previously decided[16] that we will only run a tender in relation to specific onshore electricity transmission projects, where we consider the benefits of running a tender would significantly outweigh the potential costs and risks involved. We identified such projects using a set of criteria: new, separable and high value. We set out initial details in our May open letter[17] and our October consultation on these definitions.

[16] ITPR Final Conclusions, March 2015: https://www.ofgem.gov.uk/publications-and-updates/integrated-transmission-planning-and-regulation-itpr-project-final-conclusions

[17] Criteria for onshore transmission competitive tendering, May 2015: https://www.ofgem.gov.uk/publications-and-updates/criteria-onshore-transmission-competitive-tendering

2.2. Having reviewed and analysed responses to our last consultation, we confirm our decision to use these criteria and provide further detail on the definitions of the criteria.

Our approach to assessing impacts of tendering projects

2.3. We set out in our March 2015 impact assessment, and again in our updated impact assessment, supplementary to this document, our assessment of the case for competition for onshore transmission assets. We consider this assessment sets out the case for competition across projects. Through our updated impact assessment, together with defined criteria for selecting which projects we may run a competitive tender for, we consider that we have set out a robust framework – both for selecting these projects and for justifying competitive tendering.

2.4. We recognise that the SWW projects, being developed during the RIIO-T1 price control, have been developed and progressed by incumbent TOs, and have already been funded for pre-construction activities through the current price control. Before making a decision to tender any RIIO-T1 SWW projects we will consider, on a case-by-case basis, whether tendering would be in the overall interests of consumers. We discuss this in more detail in paragraph 2.48. We consider that such project-specific assessments will enable us to fully consider the impacts of running a tender in relation to each RIIO-T1 SWW project.

2.5. Some stakeholders have suggested that we may better define the case for tendering through the use of project-specific impact assessments. For RIIO-T1 SWW projects, we will carry out additional assessment to confirm suitability as described above. For RIIO-T2, we will make the decision on whether the criteria for tendering are met earlier in the project's development, therefore parties will take forward work aware that a competitive tender will be run. Parties will also be aware of the detail of how the competitive regime will operate. We consider it is important to provide this clarity and certainty as early as possible as this will help clarify responsibilities on project development, provide regulatory certainty and confidence in our decisions and help drive a more competitive market. As such, we do not consider project-specific impact assessments are efficient or appropriate before making a decision to run a tender, as they would lengthen the process and lead to uncertainty around which parties are responsible for developing projects.

Detailed criteria definitions

2.6. We have considered responses provided by stakeholders to our October consultation. Having developed them further, we set out here further detail for the definitions of new, separable and high value criteria. We anticipate periodically reviewing these criteria, to ensure they are appropriate and maximise benefits for consumers.

New

The new criterion will mean either a completely new transmission asset or a complete replacement of an existing transmission asset.

Separable

Transmission assets are separable if the boundaries of ownership between these assets and other (existing) assets can be clearly delineated.

Transmission assets do not need to be electrically contiguous or electrically separable from other assets to be considered separable.

However, the SO may on a case-by-case basis propose electrical separability at project interfaces, if the SO considers there is a cost-benefit justification for this.

High Value

The high value threshold will be set at £100m of expected capital expenditure.

This expected capital expenditure will be set at the point of our initial assessment of whether to tender the project.

The £100m threshold will be a fixed nominal value and not indexed to a reference year. The value of the project will be assessed in the price base of the year of the assessment.

The high value threshold will be kept under review to ensure the benefits of tendering continue to significantly outweigh the costs.

New and separable

2.7. We confirm that a project will be considered new and separable if it involves the construction of transmission assets where none currently exist (ie 'greenfield' assets') or where the new assets will completely replace existing assets. In either case the ownership boundaries must be clearly delineated, so responsibility for each asset can be clearly established. Most respondents to our October consultation supported our proposal for the new and separable criteria.

New

2.8. In our October consultation we asked for views on our proposal that the new criterion should be defined as 'completely new' and not 'substantially new'. Most respondents were supportive of this proposal. The majority of respondents who commented on this proposal noted that for almost all late CATO build tenders there

will be 'non-physical assets'[18] such as preliminary works, land or access agreements which relate to the tendered assets that will be necessary for the development of those assets. They agreed with our proposal that these assets should transfer to the CATO. These non-physical assets, although necessary for the development of a new transmission asset, are not in themselves considered to be part of a transmission system.[19] Therefore, they will not be assessed against the new criterion and the need for non-physical assets to transfer from an existing asset owner to the CATO, should not preclude a new transmission asset from satisfying the new criterion.

2.9. Some stakeholders noted that there could be limited circumstances where it may be necessary or efficient for the development of new assets for some 'existing physical assets', such as elements of interfacing assets, eg a substation bay, to be transferred from the incumbent party to the CATO. We recognise that new CATO assets may be developed in close proximity to existing physical assets owned by incumbent TOs, or at direct interfaces with existing physical assets. As such, there may be a need for the CATO to either have access to the existing physical assets, or in limited cases, take ownership of those existing physical assets.

2.10. We would expect that in circumstances where access to existing physical assets is required, this would, as a general principle, be managed through standard industry practices, in particular interface agreements between the CATO and the existing asset owner. We would expect that an interface agreement would set out the responsibilities and obligations of both parties and any potential liabilities in accordance with industry frameworks.[20]

2.11. Where access agreements are insufficient, it may be necessary to transfer existing physical assets to the CATO, for the purposes of efficient construction and operation. We consider that the instances in which this might occur are likely to be limited. However, for completeness, we have set out principles for how this transfer would be managed later in this chapter.

2.12. Where a competitive tender is to be run in relation to a project that involves the complete replacement of an existing transmission asset, the existing assets will require decommissioning. Our default assumption is that the existing asset owner should be responsible for decommissioning their assets in line with the obligations and funding requirements in their licence. There may however be instances where it

[18] This relates to assets which do not constitute physical constructed transmission assets. We set out in Footnote 19 the definition of 'transmission assets'.
[19] As defined in Section 4(4) of the Electricity Act 1989, a transmission system means a system which (a) consists (wholly or mainly) of high voltage lines and electrical plant, and (b) is used for conveying electricity from a generating station to a substation, from one generating station to another or from one substation to another.
[20] As an example, schedule 15 of the System Operator - Transmission Owner Code sets out a standard Transmission Interface Agreement relating to the installation and operation of transmission assets of one party on the property of the other party at an interface point: http://www2.nationalgrid.com/uk/industry-information/electricity-codes/stc/the-stc/

is more economic and efficient for the CATO to be responsible for decommissioning of the existing assets. Again, we consider that the instances in which this might occur are likely to be limited, however, for completeness we have set out principles for how this would be managed later in this chapter.

Separable

2.13. The majority of respondents to our October consultation were supportive of our proposals that neither electrical contiguity nor electrical separability should be a prerequisite to meeting the new and separable criteria. Stakeholders also supported our proposal that electrical separability may be proposed by the SO where it considers there is a cost-benefit justification for its inclusion. Some noted that there are currently ownership boundaries within the existing electricity transmission system which are managed in line with industry codes and standards, including interface agreements and site responsibility schedules.

2.14. We confirm that any transmission assets required by a CATO to comply with obligations under its licence would meet the separable criterion if it is possible to clearly delineate the boundaries of ownership and responsibility between those assets and other assets. These boundaries should be defined through legal and contractual ownership responsibility.

2.15. We confirm that it is not necessary for the assets to be electrically contiguous (direct and electrical connection) nor to be electrically separable to meet the separable criterion.[21]

2.16. We also confirm that, as part of the project identification process, the SO may, on a case-by-case basis, propose electrical separability at project interfaces, where this would not otherwise be included. In such cases the SO should submit to us a cost-benefit analysis for its inclusion and we would determine whether to introduce additional electrical separability based on our assessment of the SO's analysis.

High value

2.17. We have decided that the high value threshold should be set at £100m of expected capital expenditure (capex). The threshold of £100m was broadly supported by respondents to our October consultation with several noting that this represents a suitable threshold to ensure the benefits of running competitive tenders for these projects significantly outweigh the costs. Several potential bidders indicated a willingness to bid on projects of this value or greater. However, some respondents

[21] We consulted on our proposal that electrical contiguity and electrical separability should not be a prerequisite for meeting the separability criterion in May 2015 and confirmed our proposal in our October consultation.

considered that a higher threshold would be more appropriate to ensure the benefits of tendering significantly outweigh the costs. In our updated impact assessment we have further considered the anticipated costs and benefits associated with onshore tenders, having regard to the points raised by respondents. Following this analysis we continue to consider that the benefits of tendering projects of £100m or greater will significantly outweigh the costs.

2.18. We also confirm that the high value threshold should relate to the estimated capex for the project, rather than the expected whole life costs. We consider that capex can be more easily estimated and avoids the need to make estimates of whole life costs which could be complex. In addition, we consider capex to be an appropriate proxy for whole life costs. This proposal was supported by the majority of respondents to our October consultation.

2.19. We consider that the £100m value should be a fixed (nominal) value and should not be indexed to the value in a particular year. We consider that this approach is most appropriate as it is more straightforward to identify which projects will meet the threshold and avoid the need to determine the appropriate index to link to and what discount rates should be applied. The estimated capex of a project will be assessed against the high value criterion in the price base of the year in which we make this assessment. This is aligned with the processes set out in the current NOA methodology,[22] which assesses options in the price base of the assessment year.

2.20. We confirm that the high value threshold should be kept under review, however, to ensure that the benefits of tendering are not diminished by changes in inflation, but also to review the overarching value of £100m. This proposal was supported by a number of respondents to our October consultation, in particular those who considered that there may be benefit from tendering projects below the £100m threshold in future once the regime is established.

2.21. Whilst we may run a tender in relation to projects during the RIIO-T1 period if they are at or above the £100m threshold, this will only be applicable to SWW projects, in line with our RIIO-T1 Final Proposals. The TOs requested specific financial thresholds for SWW projects as part of their final RIIO-T1 business plan submissions, above which projects would be managed via the SWW uncertainty mechanism. These thresholds were considered, consulted upon and reflected in the RIIO-T1 price control. For NGET this is £500m, for SP Transmission this is £100m and for SHE Transmission, this is £50m. Some stakeholders have raised concerns that this could create a difference in treatment for projects between £100m and £500m in England and Wales (which would not be considered for tendering in RIIO-T1), as compared to Scotland (where all projects at £100m or above would be considered for tendering in RIIO-T1), and that this could potentially be discriminatory.

[22] http://www2.nationalgrid.com/UK/Industry-information/Future-of-Energy/NOA-Methodology/

2.22. Our view is that this is not discriminatory. We consider that this distinction is a product of the thresholds requested by the TOs in their business plans which formed the initial proposals that were consulted upon and determined in Final Proposals for the RIIO-T1 price control. These thresholds were proposed by the TOs, and reflect the business needs and risk appetite of those companies. We do not consider it proportionate or good regulatory practice to re-open these thresholds to amend this distinction. We also consider that it is important for regulatory stability for us to honour our previous commitment to only consider SWW projects for tendering in RIIO-T1. Finally, we do not consider it would be appropriate to adjust the high value threshold for RIIO-T1 to £500m, as this would limit the scope of potential projects which could be considered for tendering and thus limit potential benefits for consumers.

Asset ownership and responsibilities

2.23. As set out earlier in this chapter, we expect asset ownership and responsibilities for projects to fall under one or more of the arrangements below:

2.24. **Non-physical asset transfer**: the transfer of preliminary works, land or access agreements necessary for a project to be developed. This could include consents, land rights, surveys etc. We expect these assets will always be required to transfer to the CATO for all late CATO build tenders. We think this is important to enable the CATO to undertake its role in the design finalisation, construction and operation of its future assets effectively. We will discuss how the transfer of these assets will be managed in our summer consultation on tender models and market offering. This will include consideration of the different regional planning regimes in GB.

2.25. **Existing physical asset access and operational agreements**: operational responsiblities and liabilities at the interfaces between a CATO's project and an existing owner's assets. These circumstances are likely to be managed through commercial agreements for access and operation, and supported by/rely on industry codes such as the CUSC 'principles of ownership'.

2.26. **Existing physical asset transfer**: where physical assets are required to transfer from the existing owner to the CATO to enable efficient delivery of the CATO's project, eg specific existing interface assets. As set out earlier, we consider that the instances in which this might occur are likely to be limited.

2.27. For RIIO-T1, we intend to consider asset ownership and responsibility when reviewing whether a competitive tender should be run. For RIIO-T2, we would expect asset ownership and responsibility, and in particular the need for any transfer of physical assets to the CATO, to be identified through the system planning process and early project design process. We would then consider the approach when reviewing the initial tender checkpoint (ITC) – see 'Considering projects against the criteria – RIIO-T1'.

2.28. Further details on the valuation of any assets to be transferred are set out in Chapter 3.

Distribution assets

2.29. Currently as part of transmission asset development it is sometimes necessary for ancillary works on distribution assets to be undertaken at the same time, eg relating to interfaces between the systems, or for required decommissioning of assets. In these circumstances, we expect that the distribution network owner (DNO) would carry out the relevant works on their own assets and recover costs from the TO.

2.30. Where incumbent TOs have interfaces with DNO assets, we would expect commercial agreements to be established to set out responsibilities, obligations and liabilities for these arrangements. We expect that these agreements would operate in line with standard industry practices. We would also expect that these could be transferable to a CATO, but would need to consider the efficiency of such arrangements on a case-by-case basis.

Scope of projects

What is a 'project'?

2.31. We continue to consider, as we proposed in our open letter in May 2015,[23] that the criteria should be applied to projects developed to meet a need or multiple needs on the transmission system. We consider that a project is an efficient package of works, or multiple packages of work to be delivered together which have been identified to meet a common need on the transmission system. We would expect the packaging of projects to take into consideration the timing of the need, the anticipated timescales for delivery, the location(s) of the works and the relationship between the new works and the existing network.[24]

Principles for project packaging

2.32. In general we would expect projects to be assessed against the criteria for competition and, if considered suitable for tendering, this will provide the basis for the scope of the tender. However, in some cases we expect that additional principles (as set out below) may be required to help define the scope of the package of works to be tendered. For example, if the entire package of works proposed contained

[23] https://www.ofgem.gov.uk/publications-and-updates/criteria-onshore-transmission-competitive-tendering

[24] This process also takes into account the extent of electrical separability in a project, as well as what electrically non-contiguous assets, if any, to take forward together. https://www.ofgem.gov.uk/sites/default/files/docs/2015/05/criteria_open_letter_0.pdf

some overhead line upgrades, as well as a new subsea cable and a new substation, the cable and substation could potentially be re-packaged to form a new, separable and high value project.

2.33. In October, we consulted on our proposal that the SO should assess whether there are aspects of the project which form a sensible package of works that meet the criteria and should be tendered, and that we will scrutinise this process. Respondents supported this proposal and considered this would ensure opportunities for competition are not missed. We confirm that we intend to use this approach.

2.34. We expect that projects will be packaged through their relevant identification routes, eg NOA, connections process. However, we reserve the right to revise the packaging of tendered projects where appropriate to ensure that:

- the project identification process is efficient.
- where projects come forward, they are scoped in a way that ensures better outcomes for consumers through the most efficient competitive tender process.

2.35. We propose, and are seeking views on, the following principles for packaging projects – we would consider applying these principles as part of our tender checkpoint assessments which consider whether to tender a project.

Bundling – combining smaller projects

2.36. By 'bundling' we mean combining one or more projects into a single tender. We may consider bundling projects with common need/drivers, where this makes technical or commercial sense, however we would only expect to do so where this was in the interests of consumers. This would only apply to projects already above the high value threshold in the first place.

Splitting – separating larger projects

2.37. For some projects we may consider a better outcome for consumers could be achieved by tendering in several packages, ie via separate tenders. In doing so we would consider the impact this could have on project delivery, eg coordination of multiple constructing parties, suitability for tendering of the separated packages, as well as market interest.

2.38. Circumstances where we may want to split a project could include:

- If a project were particularly high value, it may be less attractive to the market or limit the pool of potential bidders.
- If different technology clearly suggests that different skills and procurement are needed for the separate elements.

- If a project required mutli-phase construction, eg construction over a lengthy period, in discrete and separate locations – this could better be managed via phased tenders rather than a single tender.

Re-packaging – re-specifying scope of projects

2.39. We propose that we will consider re-packaging a project where certain elements of a project do not meet the criteria. We would carry out this exercise only where we considered there would be benefits to consumers in doing so. There are likely to be three main reasons why we might want to repackage a project in this way:

- **Related to new criterion** – if the majority of a project proposed is brand new or a complete replacement, but a small proportion involved updating/renovating existing assets.

- **Related to separable criterion** – if a project as proposed would not be considered separable, but could be re-packaged through minor re-scoping to make ownership boundaries easier to define.

- **Related to timing (RIIO-T1 only)** – timing of elements of a RIIO-T1 project vary such that it may be sensible to separate earlier and later components.

2.40. Any such decision would need to consider the regulatory treatment of non-tendered components, ie to reflect that these had a route for regulatory consideration.

Considering projects against the criteria – RIIO-T1

Our process for considering non-competed SWW projects in RIIO-T1

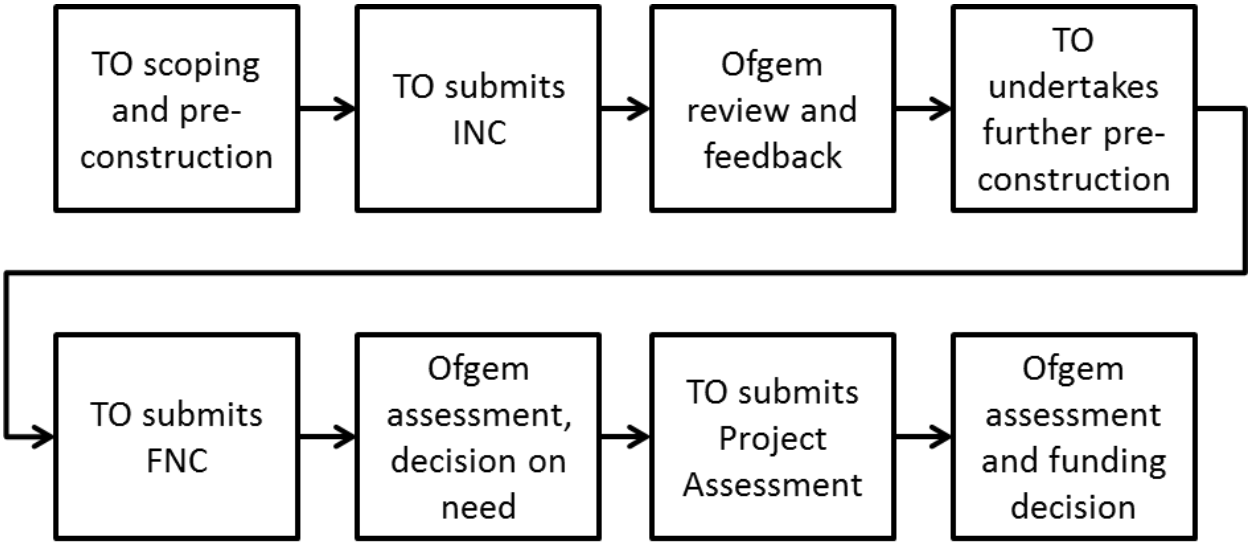
2.41. Under the SWW regime, the incumbent TOs manage the timetable and pre-construction activities for each project. TOs undertake all pre-construction activities, which includes work such as: Optioneering of potential solutions, technical development of the preferred solution, stakeholder engagement, environmental studies and site surveys, gaining consents for the project – onshore and offshore, acquiring land rights, procurement engagement, tendering activities and provisional contracting.

2.42. Our role in the SWW regime is initially focused on assessment of the need for the project. We have now split this into two stages: initial needs case (INC) [25] and

[25] We have only recently introduced the INC stage – this stage will only apply to projects that have not progressed past the point where an INC would normally be run. Some existing SWW

final needs case (FNC). Once the FNC is confirmed (usually after planning consent for the project is secured and/or after the needs driver for the project has been confirmed, eg via a final investment decision by a large generator), we then undertake an assessment of proposed costs (project assessment). After our decision on the project assessment, TOs can recover the efficient costs from consumers for construction and operation of the assets. The overall process, including both TO and Ofgem actions, can be seen in Figure 3.

Figure 3: Process diagram of TO and Ofgem actions for the SWW regime

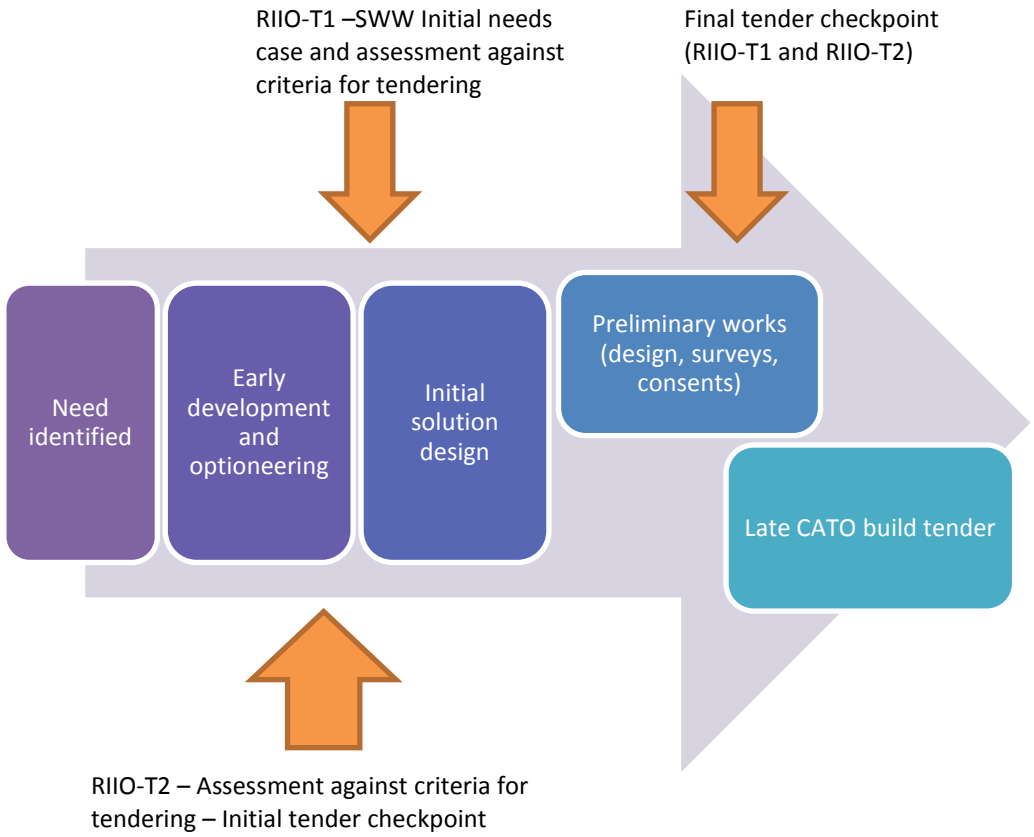


Our high level process for considering competed projects

2.43. In Figure 4 we have set out a high level timeline for the process projects are expected to follow from identification of initial need through to a tender, during RIIO-T1 and RIIO-T2. The remainder of this chapter explains the detailed process for key elements of this timeline, relevant to our decisions on whether to tender projects. The 'final tender checkpoint' (FTC) stage is covered in Chapter 3.

Figure 4: High level timeline for late CATO build activities from early project development to point of tender

projects are being developed without an INC.



Project identification

2.44. As set out previously, we will assess SWW projects proposed to us by the TOs during RIIO-T1 to determine whether they are suitable for competitive tendering. We will also consider other relevant factors such as timing and transferability of existing work. This decision-making process is discussed later in this chapter.

Network Options Assessment

2.45. We intend that, going forwards, tendered projects will principally be identified through the SO's NOA process. This process was created as a conclusion of the ITPR project. It is intended to provide a system-wide holistic outlook, to assess and compare solutions to system needs, including providing recommendations on options for competitive tendering.

2.46. Through the NOA process, the SO will make recommendations on the suitability of projects for tendering. This process should include the publication of an annual report updating a 10-year outlook on reinforcement solutions/options and making recommendations for which of these should be tendered. This report should be consulted on and stakeholders should have the opportunity to input into this process.

Process for applying the criteria

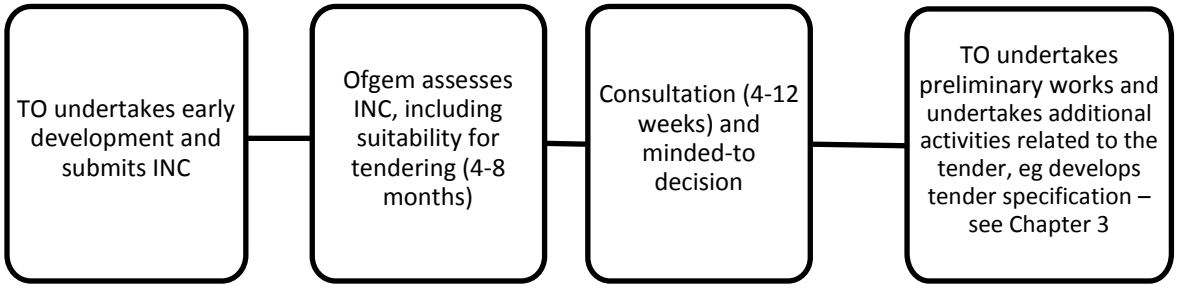
2.47. We stated in our October consultation that for RIIO-T1 SWW projects, "*in addition to considering whether these projects are new, separable and high value, we will also consider the effects of tendering projects where incumbent TOs have already undertaken significant pre-construction work*."

2.48. This means that for these projects we will consider whether tendering would be in the overall interests of consumers. As such we expect our considerations to include the timing implications of any decision to tender (ie in terms of potential for material delay to the timing of project delivery), the transferability (to the incoming CATO) of works undertaken by the TO before the tender (in terms of cost and timeliness to transfer), as well as the value of potential cost savings to consumers from tendering.

Timing and process for tendering decisions

2.49. Figure 5 sets out the process we intend to use to consider whether to tender a RIIO-T1 SWW project, as well as indicative timings for doing so.

Figure 5: Process for decision to tender a RIIO-T1 SWW project



2.50. We will consider whether to tender SWW projects being developed by the incumbent TOs when we consider each SWW needs case submission during the RIIO-T1 period. We will consult on our view on tendering alongside our view on the project's INC, followed by a minded-to tendering decision.[26]

2.51. If the minded-to decision is to run a tender, the TO would undertake all relevant preliminary works along with the additional tender related activities. These activities are described further in Chapter 3.

[26] We will confirm this decision at the FTC, following final confirmation of the project need.

2.52. Some SWW projects are sufficiently advanced, such that their preliminary works have largely been completed and the project has therefore progressed beyond the point where we would review an INC. In such circumstances we would consider whether to tender a project at the FNC stage.

Considering projects against the criteria – RIIO-T2

Project identification

2.53. For projects which would begin construction during the RIIO-T2 period, any onshore transmission assets which are new, separable and high value may be tendered. For RIIO-T2, we expect to identify projects which are suitable for competitive tendering earlier in the project development process. This would be once the SO has recommended the most appropriate transmission solution to be taken forward, and before the preliminary works commence.

2.54. The majority of respondents to our October consultation were supportive of our proposal for the role of the SO in identifying and recommending suitable projects for tendering in the NOA report. One respondent highlighted that the current obligation on the SO to develop the NOA does not capture large generator connections, non-load related projects / reinforcement works which take place within the existing system boundaries. They expressed concern that opportunities for competition, and cost savings for consumers, could be missed.

2.55. We expect the NOA process to identify and recommend many of the projects which are suitable for tendering, but we recognise the focus of the NOA on identifying major national transmission reinforcement projects driven by boundary changes to the transmission system means it will not capture the entire possible pipeline of projects for competition. We therefore expect that the SO will in future identify whether the transmission construction works included within a generator connection offer (which would not result in a boundary change) would meet the criteria and make a recommendation in relation to competitive tendering. We are currently working with the SO to develop a process to identify and assess non-load driven / reinforcement works that don't require a change to the existing transmission system boundaries against the criteria for competition. This is likely to run in parallel to the NOA.

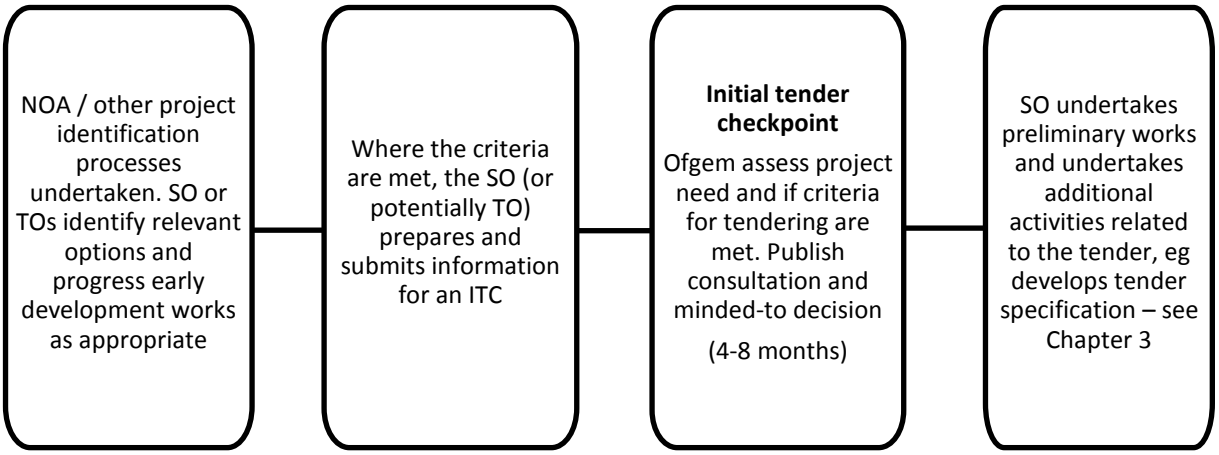
2.56. Once we have further clarity on the potential pipeline of future generator connections that might meet the criteria for tendering, we will consider the most appropriate tender models for delivering those projects. We consider that such projects would still most likely be delivered under early CATO build or late CATO build. However, there may also be scope for additional involvement of the generator in delivery of the transmission project before the tender to appoint the CATO. For example, the generator could carry out preliminary works under a late CATO build

type model, or the generator could consent and build the transmission project before a tender for a constructed asset, similar to OFTO 'generator build' tenders to date. These models could have value for large generator 'sole-use'[27] connections, under certain circumstances, and we will investigate whether to introduce them as an option from RIIO-T2. We recognise that these models go beyond our current tendering proposals and expect to assess the impact of their introduction. For such models to have value for consumers, we'd have to look closely at incentives, costs, benefits, cost reflectivity of transmission charging arrangements and the effects on other generators and the wider network.

Potential process for applying the criteria

2.57. A potential high level process for applying the criteria in RIIO-T2 is illustrated in Figure 6.

Figure 6: Potential process for decision to tender a RIIO-T2 project (late CATO build)



SO-led options and early development works

2.58. It was a conclusion from the ITPR project that the SO should identify options which are not identified by TOs, eg cross-regional solutions, alternative build solutions, or wider benefit offshore solutions which wouldn't be brought forward by an offshore developer. This should also include any options proposed by TOs, but which they have since abandoned, where the SO considers there is merit in still considering these options from a whole-system perspective.

[27] ie where the new, separable and high value transmission assets are only needed by the generator triggering the connection request.

2.59. We confirm our decision, as set out and justified in the ITPR Final Conclusions, and our October consultation, that the SO should be responsible for the 'early development works' associated with SO-led options.[28]

2.60. 'SO-led' options refers to the SO developing options with such sufficiency that they can be compared to other options under the NOA process. We expect early development works will include analysing the capacity to be provided, technology choices and high level routeing – all undertaken through desktop analysis. We do not however expect this would involve any field analysis (eg surveys). For tendered projects, the early development works would conclude with the submission of the information necessary for the ITC.

2.61. Following a positive assessment against the criteria for onshore tendering, and decision on the need for a project at the ITC, we have previously set out that the SO would undertake the preliminary works for that project, along with any additional works needed to facilitate the tender. This is discussed further in Chapter 3.

TO-led options and early development works

2.62. In our October consultation we suggested the SO may be responsible for leading the early development works for all tenderable options. While we consider that the SO should lead the overall process for identifying competed projects in RIIO-T2, we expect TOs to continue to identify the most appropriate options within their licensed area for inclusion within system planning considerations, irrespective of whether these options may be suitable for competition. In time, once appointed, CATOs are also likely to have an important role to play in identifying the most appropriate options within their licensed area for inclusion within system planning considerations. We would also expect the SO to challenge the TOs' (and in time CATOs') proposals where appropriate.

2.63. As such, we would expect TOs to put forward a range of 'TO-led' options within their licensed area, which may include a combination of options that meet the criteria for tendering, as well as options that don't meet the criteria for tendering. 'TO-led' options here refers to the TO developing options with such sufficiency that they can be compared to other options under the NOA process.

2.64. For a TO-led option that meets the criteria for tendering, the TO would submit the necessary information on the project at the ITC. Given that only early optioneering analysis will have been undertaken on these options at the point of the ITC, we do not consider a need for a formal transfer process between the TO and SO

[28] We also confirm the ITPR conclusion that the SO should be responsible for undertaking the early development works associated with non-developer associated offshore wider works, which would otherwise not have a driving part (see standard condition C27 of the electricity transmission licence).

in any such instance as relevant analysis will have been made available to the SO through the NOA process.

Initial tender checkpoint

2.65. In RIIO-T2 we will make a minded-to decision on tendering at the ITC.

2.66. As set out in our October consultation, and confirmed here, at the ITC the SO[29] will recommend to us whether a project meets the criteria for tendering and whether there is a technical and economic need for the project to proceed. Given that we expect to identify projects which are suitable for competitive tendering earlier in the project development process than during RIIO-T1, we would not need to consider the effects of tendering projects where incumbents have already undertaken significant pre-construction work.

2.67. We will decide at the ITC stage whether the criteria are met and which tender model to use. We will also decide the next steps for the project, including the potential timing of the tender. We currently expect to consult on this decision. We intend to set out further detail on the process and information requirements for the ITC in a subsequent publication.

2.68. In line with the arrangements set out in Chapter 3, we expect to make a final decision on whether to tender a project at the FTC stage, once the need for the project is confirmed.

[29] Or TO, for TO-led options, as set out earlier.

3. Pre-tender arrangements

Chapter summary

This chapter sets out our latest proposals on the pre-tender arrangements for late CATO build during RIIO-T1. These include roles and responsibilities, incentive and funding arrangements, as well as the process. We also set out our initial considerations for RIIO-T2 arrangements, which we'll consult on further at a later date.

Question box

Question 6: What are your views on the suggested process for carrying out the pre-tender roles?

Question 7: Regarding preliminary works and the tender specification:

- **(a)** What are your views on the scope of the baseline tender specification?
- **(b)** How likely is it that additional preliminary works will be required, and if so, what types of works are likely to be required?
- **(c)** What are your views on:
  - **(i)** The role of bidders in identifying the need for further information / additional preliminary works (eg additional independent surveys) to inform robust bid assumptions?
  - **(ii)** The most efficient process for enabling this?

Question 8: What are your views on the proposed arrangements for the data room and bidder clarifications?

Question 9: What are your views on our proposals regarding the funding of preliminary works and tender support activities in RIIO-T1?

Question 10: Do you have any initial views on risk allocation across the preliminary works party and the CATO?

Overview

3.1. Where we decide to tender a RIIO-T1 SWW project (under late CATO build), the TO will be responsible for the preliminary works and preparatory activities required ahead of a tender. We consider that incumbent TOs should undertake this role for RIIO-T1 because the TOs have already initiated these works and received funding for 'pre-construction works' under the SWW regime. We consider that it would not be efficient for another party to repeat or complete the remainder of the works before a tender during RIIO-T1.

3.2. In our October consultation we set out high level roles under a late CATO build tender model. In this document we set out further details on the proposed preliminary works and tender support roles. We expect that after the decision to tender a project during RIIO-T1, the TO will be responsible for:

- continuing to determine an ongoing need for the project.
- undertaking and completing all necessary and appropriate preliminary works (eg early design and consenting) for the project.
- undertaking any necessary preparatory activities in advance of the tender (eg creating a 'tender specification' which would provide the basis for a tender and set out the detailed project information needed for bidders to effectively develop robust bids for the tender).
- before and during the tender process, putting relevant documentation into a virtual 'data room', and supporting the efficient running of the tender process (eg via responding to bidder due diligence enquiries 'clarifications'). This broadly mimics the established role for offshore generator developers in the OFTO regime.

3.3. We commissioned external consultants, TNEI/Pöyry, to consider the scope of the preliminary works and the associated tender specification. Their full report is published alongside this consultation. We have used the TNEI/Pöyry report to inform our initial proposals set out in this chapter regarding the scope of the preliminary works and associated tender specification. We welcome your views on these proposals, both as summarised in this chapter and as set out in full in the TNEI/Pöyry report.

3.4. TNEI/Pöyry also set out their initial views on risk allocation. Whilst we welcome views on risk allocation as set out in the report, we will be consulting with more detail in our summer consultation on the tender models and market offering for CATOs.

Preliminary works and tender specification for tendered projects in RIIO-T1

3.5. In our October consultation, we proposed that an incumbent TO's role in any late CATO build tender during RIIO-T1 would be to undertake the preliminary works for a project and carry out any necessary preparatory activities in advance of the tender. Stakeholders were broadly supportive of the overarching roles identified.

3.6. For any SWW projects tendered in RIIO-T1, we intend to oblige the incumbent TO to be responsible for completing the preliminary works, ie the development works required to progress a project during its early stages, including activities such as high level design, consenting, and land rights acquisition. We propose to place obligations (via licence modification proposals) on the TOs to undertake and

complete the preliminary works for projects they have brought to us under the SWW regime that we assess as suitable for tendering.

3.7. We have decided not to set out an exhaustive list of preliminary works activities here. The activities required for each project will be contextual, for example not all projects will need offshore surveys. We have instead sought to define a 'baseline tender specification', capturing the range of information which we consider necessary to inform robust and efficiently costed bids.

3.8. Set out in Table 1 below is an overview of the proposed baseline tender specification and the associated preliminary works. The detailed list of contents is available in Annex C of the TNEI/Pöyry report, along with a set of justifications for inclusion for each item.

Table 1: Summary of proposed baseline tender specification and associated preliminary works

Category	Type	Documents
Design	Concept	Needs Case Report; Optioneering Report; Functional Specification; Single Line Diagram; records of supply chain engagement; conceptual project plan/programme.
	Preliminary	Route corridor study report; initial drawings/designs and specifications for major components; initial plans and specifications for construction techniques access and logistics; reporting on any supply chain limitations due to initial design choices; contracts, designs etc for any early procurement.
Studies/ Surveys	Geotechnical	Geotechnical desk study; peat slide risk assessment report and data; phase 1 contaminated land report; preliminary UXO/UXB risk assessment; borrow pit assessment report; ground investigation report; targeted topographical survey report.
	Ecological	Phase 1 Habitat report; protected species survey reports; hedgerow survey reports; national vegetation classification survey report; ornithological survey reports;
	Logistics	Initial access studies and feasibility; Traffic Impact Assessment; Approval in Principle (AIP) with relevant highways authorities.
	Electrical	System studies reports; contingency analysis reports; TO and SO Outage schedule; detail of DNO crossings; system models/data; harmonics data; information on TO and SO interfaces (eg design of electrical boundaries); information on third party interfaces (eg

		generators, other CATOs).
	Offshore	Offshore geotechnical report based on geophysical surveys as a minimum; metocean study based on regional modelling as a minimum; Information on availability of offshore installation vessels.
	Other	Noise assessment report (initial design); noise assessment report (detailed design); construction noise assessment; Landscape and Visual Impact Assessment; Electro-magnetic Field assessment; flood risk assessment; archaeological assessment; detailed geotechnical assessment of ground conditions; detailed archaeological assessment.
Consenting	Social Commitments	Statement of Community Engagement; summary of (or copies of) consultation responses; community liaison group minutes.
	Application Process	Application documents; draft or final consents/licences; summary of pre-application discussions; submissions and documents (eg gatecheck Reports; written responses; inquiry reports).
	Consents	Depending on project type and location would include: Section 37 Consents & Deemed Planning Consents; Development Consent Orders; Marine Licences; planning consents for elements consented through the Local Planning Authority/Local Authority.

3.9. We consider that any other relevant documents produced as outputs of the preliminary works should also be provided to bidders where appropriate, even if not included in the baseline tender specification list. For example, there may be benefit in releasing to bidders the underlying data from reports for the purposes of due diligence.

3.10. The preliminary works are broadly analogous to SWW 'pre-construction' works. However not all SWW activity will be required if an SWW project is to be tendered. Our default position is that the TO should not undertake any supply chain procurement or construction work for a SWW project which is to be tendered. However, if the TO considers that some early construction activity or procurement is necessary to appropriately progress the project ahead of a tender, we would expect to assess any justification for this before it is taken forward.

3.11. There may be cases where the tender would benefit from additional preliminary works beyond that planned for by the TO under their original SWW pre-construction activity scope. For example, further detailed surveying work may better inform construction activities such that bidders can reduce their contingency funding. We would seek to identify whether these works are required and fully justified on a

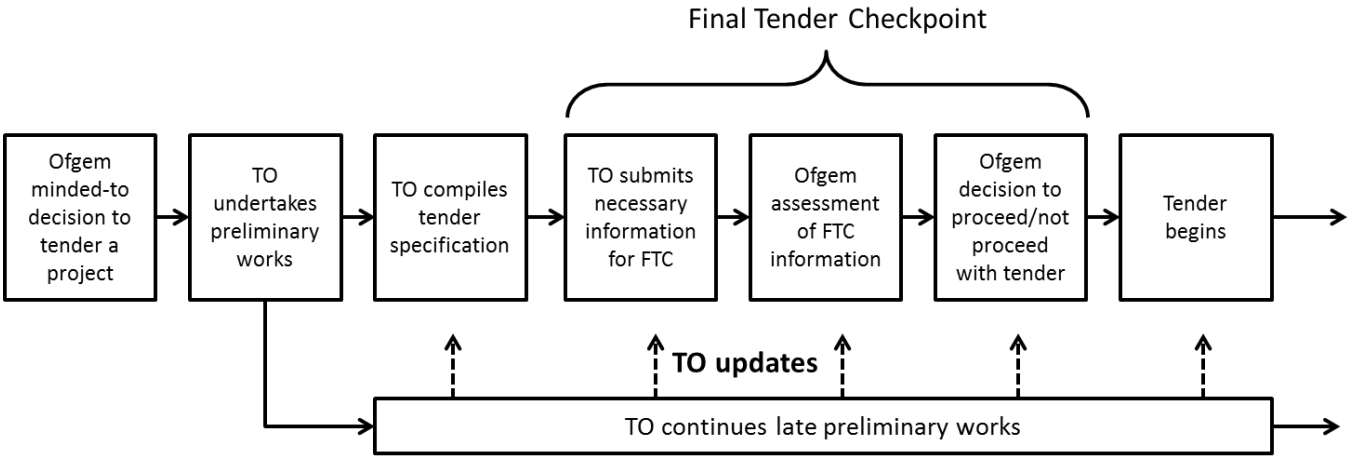
project-by-project basis, in collaboration with the TO, and through our assessment of the planned works in the TO's INC submission. Where any additional works are identified, we propose to require the TO to undertake those works in addition to the works required to produce the baseline tender specification.

Timeline and process for submission to Ofgem in RIIO-T1

3.12. Where we indicate that a project is suitable for tendering, we will notify the TO of the documents they need to submit to us at the FTC, as well as the indicative timing for the FTC. The documents to be submitted will include the tender specification. TNEI/Pöyry consider that a TO would not have to significantly bring forward its preliminary works activities to complete the tender specification. We therefore expect that the TO would be able to complete the tender specification in a timely manner and ahead of submission to us at the FTC.

3.13. The FTC stage is for us to confirm that it is appropriate to proceed with the tender. The FTC is somewhat equivalent to an SWW FNC assessment. However, we expect this is likely to be initiated earlier, whilst final preliminary works are being completed. Figure 7 sets out the broad process around the FTC and how it relates to development of the preliminary works and submission of the tender specification.

Figure 7: Process diagram for the final tender checkpoint



3.14. We expect that the FTC stage will take around 3-6 months.

3.15. Our assessment at the FTC stage would include consideration of the following elements:

- The ongoing need for the project (similar to the current FNC step of our SWW assessment).
- Any changes in the scope of the project since our assessment at the INC.

- An update on progress of the preliminary works, including the status of the planning consents and land/access rights. Depending on the timing of the FTC, some elements of the preliminary works, for example final planning consent approval and conditions, may not be concluded by the time of the FTC.

- The contents and suitability of the tender specification and associated documents that will be used to populate the project 'data room'.

3.16. Where we confirm a positive view on the suitability for tendering at the FTC stage, we would then confirm when we intend to commence the tender.

3.17. If we conclude at the FTC that the project is no longer needed, for example through changes in the generation or demand background, we would not proceed to tender. If the need for the project was to return at a later date, we would recommence the FTC stage again after any required remedial work by the TO to the tender specification.

Tender support

3.18. We set out below a number of activities which we expect the TO to undertake in preparation for and in support of the tender process. The range of activities is indicative at this stage and remains dependent on the final arrangements for the tender process. We will set out further detail on the late CATO build tender process in our summer consultation on tender models and market offering.

The TO's role in supporting the tender

3.19. We consider that the relevant TO should support the tender for any RIIO-T1 projects as they are the party best placed to do this role, having led the preliminary works.

3.20. The TO will have three main roles when supporting a tender:

- Producing and maintaining the tender specification (as set out earlier).

- Compiling and submitting documents to the project data room (including the tender specification).

- Responding to bidder due diligence enquiries ('clarifications').

3.21. Where the timings of a project require it, tender support may run alongside late preliminary works and the planning consent process (see 'Timeline and Process' earlier in this chapter). In this scenario we would require the TO to update us and the project data room with relevant up-to-date information, in a timely manner. We

will decide on the most appropriate format and timings of these updates in collaboration with the TO, taking into account the stages of the tender and the specific nature of the works.

3.22. We confirm that neither the TO nor the SO will have a role in our assessment of bids during RIIO-T1, and will not input into the evaluation framework used for assessing bids.

Data room

3.23. Under our current offshore tendering process, we utilise a virtual 'data room' to compile information and documents which are relevant to the project, to inform bids. We propose to broadly replicate the arrangements for the data room that we have used for the offshore tender process.

3.24. We currently expect to procure and structure the data room, using a similar portal to that used to support offshore tenders.[30] The TO will have responsibility to populate and manage that data room with our role limited to supervising data room activity and managing TO interactions with bidders.

3.25. The data room will contain the tender specification and supporting documents, for example documents used to support the consenting process, and detailed outputs from preliminary works – as set out earlier in this chapter.

3.26. Bidders will gain incremental access to the data room as appropriate to each stage of the tender. We expect that similar requirements for confidentiality and use of data will apply to onshore tender bidders, ie access to the project data room will be restricted and subject to confidentiality arrangements.

Bidder clarifications

3.27. Bidders may wish to raise questions or clarify items relating to information in the project data room with the TO as they put their bid together. The TO will be required to respond to these questions. This will ensure that bidders receive the most robust information during the tender process. Broadly, we propose to replicate the arrangements for bidder clarifications and questions to the TO that already exist for bidders and offshore generator developers in the offshore tender process.[31]

[30] See p.26 of:
https://www.ofgem.gov.uk/system/files/docs/2016/04/2._tr4_tenderrules_final.pdf
[31] See p.24 of:
https://www.ofgem.gov.uk/system/files/docs/2016/04/2._tr4_tenderrules_final.pdf

3.28. We propose to act as the intermediary between bidders and TOs, and monitor the contents of questions and responses. We want to make sure that bidders are treated equitably during this process. This could include, where not commercially sensitive, publishing all questions and answers in the data room, as is the practice for offshore tenders. We would expect to monitor the timeliness of the TOs' responses, and address any issues where appropriate.

Incentives and funding for pre-tender work in RIIO-T1

Incentives for preliminary works in RIIO-T1

3.29. In our October consultation we proposed a 'success fee' to incentivise the preliminary works party to efficiently carry out those activities to a high standard. In that consultation we did not make a distinction between arrangements for RIIO-T1 and RIIO-T2. Stakeholders were generally split on the effectiveness of an incentive. Of those who were against an incentive, most believed that new obligations would be sufficient to deliver the appropriate outputs.

3.30. After consideration of stakeholder responses to our consultation, and further consideration of the merits of an incentive in the RIIO-T1 period, we consider that it would not be in consumers' best interests to provide a financial incentive regime for the undertaking of pre-tender works by TOs in RIIO-T1. There is limited opportunity for such an incentive to drive the appropriate behaviours and efficiencies in the medium to longer term. Any projects tendered during RIIO-T1 will already have been significantly developed before we decide to tender them. Further, for RIIO-T2, we do not consider that TOs are the most appropriate party to undertake preliminary works.

3.31. We consider that, in this instance, the appropriate behaviours and outcomes for RIIO-T1 pre-tender works are better driven through robust licence obligations and monitoring, as well as ex-post assessment of the economic and efficient level of funding. To this end, we expect to consult on modifying TO licences and monitoring the TOs' performance to ensure that they are making appropriate and timely progress. We may also have the TOs' performance of these activities externally audited to ensure that quality is maintained.

Funding of additional activities associated with tendering a project

3.32. We propose to provide funding to the TOs for the economic and efficient costs of any additional activities associated with tendering a project that have not already been funded as pre-construction works under RIIO-T1, ie:

- where relevant, any additional preliminary works necessary for the purposes of ensuring an efficient tender.
- tender support activity, including production of the tender specification.

3.33. We propose that these works and activities are funded to a value that we will determine ex-post (ie after the works have been completed). We would scrutinise the costs proposed by the TO for these works during the tender process to determine the economic and efficient value of the works.

3.34. We propose that the cost of these works is borne by the successful CATO through its revenue. This would be managed as an indicative cost in each bidder's tender revenue stream during the Invitiation to Tender (ITT) stage of the tender, finalised during the Preferred Bidder stage, and payable to the TO following CATO licence grant.

3.35. We consider that these proposed funding arrangements should drive appropriate behaviour by the TO in performance of the relevant licence obligations, including the efficient deployment of funding and resources, and the delivery of timely and high quality outputs.

Value of transferred assets

3.36. We expect that preliminary works, such as land rights or surveys, will transfer to the CATO at licence grant, upon terms which are to be made available to bidders in the data room. We propose that the transfer value for these assets is set at zero value, as the incumbent TOs will already have received funding for these works by way of pre-construction funding for SWW projects, as a part of their business plans for RIIO-T1.

Risk allocation

3.37. We expect TOs to produce high quality and timely preliminary works and tender support, and as set out earlier, we propose to ensure this through licence obligations and funding of works. We also consider that the efficient allocation of risks and liabilities for the outputs from these works between TOs, consumers and CATOs will further drive the appropriate behaviours required to deliver high quality outputs and an efficient tender process.

3.38. We will need to define an allocation that best represents the appropriate apportionment of risk across the parties. This will likely be a combination of the TO in RIIO-T1 undertaking and managing the works, and mitigating risks through commercial warranties and liabilities, together with appropriate due diligence by CATOs during the tender process.

3.39. The TNEI/Pöyry report includes some consideration of their view of risk allocation – see Chapter 4 of that report. We will use this view to inform our thinking in this area, but it should not be considered as our final position.

3.40. We expect to provide more detail on risk allocation in our summer consultation on tender models and market offering.

Potential pre-tender arrangements in RIIO-T2

3.41. In many areas we consider the pre-tender arrangements across the RIIO-T1 and RIIO-T2 periods are likely to be similar, including much of the process for project identification and reaching decisions on tendering, as well as the nature of preliminary works and tender support. Hence, many of the policies set out earlier in this chapter may also be appropriate during RIIO-T2.

3.42. There may be some key differences however, notably around roles and responsibilities. In particular, in our ITPR Final Conclusions in March 2015, and again in our October consultation, we said where late CATO build is used for projects in RIIO-T2 the SO should carry out preliminary works and support the tender process.

3.43. Many respondents were supportive of our proposal for the SO to carry out preliminary works for projects needed after RIIO-T1. Several stakeholders noted the importance of clear separation between the SO and TO functions of NGET. However, several respondents did not support this proposal, in particular the SO and incumbent TOs.

3.44. As set out in Chapter 1, we think that putting in place the right roles, incentives and obligations for the SO in relation to competitive onshore tendering is important, but must be considered in the context of the SO's wider role and incentive framework. We will consult on this further at a later date.

4. Mitigating conflicts of interest

Chapter summary

Creating a level playing field for competition is critical to its success. We are proposing a package of obligations, business separation measures and scrutiny to address conflicts of interest where incumbent TOs carry out preliminary works and also bid, as well as measures where other bidders have knowledge of the project.

Question box

Question 11: Do you agree with our proposed requirements for incumbent TOs to mitigate potential conflicts of interest, where they are both bidding for and developing a project in RIIO-T1?

Question 12: Is internal scrutiny of the arrangements the TO has in place to mitigate conflicts of interest sufficient, or would there be significant additional value in having an independent party scrutinise and audit the TO's arrangements?

Question 13: Do you agree with our proposal to manage conflicts for other bidders?

Context and background

4.1. We are committed to ensuring that there is a level playing field for all bidders participating in a competitive tender for onshore transmission.

4.2. Incumbent TOs and the SO have existing roles in the network planning and delivery process, and receive funding through price controls. We are proposing new roles for these parties to support competitive tendering, as set out earlier in this document. The incumbent TO and other parties involved in the development and delivery of the network and may also choose to participate as bidders.

4.3. There is a risk that this could give these parties an opportunity to gain an unfair advantage when bidding, favour their interests with regards what or how projects are developed for tendering, or benefit them disproportionately from being appointed as a CATO. We use the term 'conflicts of interest' as an umbrella term for referring to these risks, although in practice we recognise that they sometimes relate to different issues and propose different measures for addressing these, depending on the nature of the risk.

4.4. In our October consultation we set out our views on the conflicts of interest that could arise from the roles of the SO and TOs in competition, and the range of measures that could be employed to mitigate them.

4.5. Most consultation respondents agreed that we had identified both the right conflicts of interest and the right management tools, but that further detail was

required on how we would mitigate conflicts in practice. In this chapter we give an update on our thinking and put forward more detailed proposals for how conflicts of interest can be managed.

4.6. In particular we consider how to address conflicts of interest arising from the following:

- the SO's role in relation to onshore competition.
- the TOs' roles in relation to onshore competition, in particular where a TO undertakes preliminary works for a tendered project in RIIO-T1.
- any other bidder with knowledge of a tendered project.

Conflicts of interest from the SO's role

4.7. The SO's proposed role in the competitive process – particularly in identifying future projects for tendering and completing preliminary works for tendered projects for RIIO-T2 – could give rise to an unfair advantage for NGET or other National Grid companies when bidding. Respondents to our October consultation agreed that the SO's proposed role in competition could give rise to conflicts of interest, and many favoured stringent separation measures to ensure that this is mitigated. A number raised the issue of further separation between NGET's SO and TO businesses.

4.8. There is a clear need for measures to mitigate these conflicts of interest. As set out previously, we are working with DECC on whether there is a case for further separation of the SO, looking not just at the SO's role in onshore competition, but across all its activities. Once that work is complete we will confirm our decision on the appropriate conflict mitigation measures that should be put in place for the SO with regard to ECIT. We intend to have these measures in place in time for implementation of the SO's additional roles relating to onshore competition (eg on system planning or on early development works for competed projects).

Conflicts of interest from the TO's role

The issues

4.9. In our October consultation we said that incumbent TOs should be able to participate in onshore tenders, subject to appropriate conflict mitigation measures being in place. The role of incumbent TOs could however provide an unfair advantage to the TO or another company within the same parent group (a 'TO bidding party') when bidding, particularly where the TO has undertaken preliminary works before a tender for a RIIO-T1 SWW project. Stakeholders agreed with the conflicts of interest we identified, and noted some additional issues, such as the knowledge held by contractors. We consider contractors under 'Conflicts of interest for other bidders'.

4.10. We are focusing on addressing these conflicts of interest for any tenders in RIIO-T1, setting out in this chapter our proposals for mitigation measures.

4.11. In the remainder of this section, in order to be clear on the issues that could arise and our proposals to mitigate them, we refer to the following constituents of the TO. We recognise that these may not in practice always reflect the precise organisational structures adopted. The measures that we propose relate to the actions of different constituents and the relationship between them:

(a) The constituent of the TO that has completed the preliminary works, the *'TO preliminary works team'.*

(b) The constituent that is compiling and submitting the bid, the *'TO bidding party'.*

(c) '*Other relevant constituents*' of the TO, ie shared services (regulatory, legal, finance) that provide corporate functions to the TO and other associated businesses.

4.12. We distinguish between legitimate commercial advantages (which we will not seek to mitigate) and potential unfair advantages, where we think there are significant issues that need to be addressed.

Table 2: Potential issues for projects where an incumbent TO is developing the preliminary works and bidding on the project

Issue	Details
Information from preliminary works	The TO will provide information on the competed project to the project data room. It will have amassed this information while completing the preliminary works. There is a risk that the TO could give the TO bidding party an advantage, after we have decided to tender a project, by: • sharing information early, before other bidders have access • sharing additional information with the TO bidding party • otherwise assisting the TO bidding party to use the data and identify key issues. The TO could do this by transferring information directly or through employees moving between the TO and the TO bidding party.
Information during tender process	The TO will have a role in answering questions and responding to clarifications from bidders. There is a risk that the TO could give the TO bidding party an advantage by: • Sharing more or different information with the TO bidding party than it does with other bidders • Alerting the TO bidding party to issues raised by other bidders

Issue	Details
	• Sharing an insight into the commercial strategy of other bidders through the clarifications process with the TO bidding party.
Bias in developing the project	The TO could have opportunities to favour the TO bidding party by the choices it makes on the design of a project, eg through technology choice, or the way it structures commercial agreements, for example, through indemnities with other parties. It may also be able to favour the TO bidding party when contracting at interface points.

Our proposed measures

4.13. In our October consultation we set out some possible measures that could be used to mitigate TO conflicts of interest when bidding on projects for which they have completed the preliminary works. These are a combination of:

- obligations on conduct.
- business separation measures.
- scrutiny.

4.14. We are now proposing a clear package of measures, including when and how they should be put in place. While there should be some core obligations and requirements that must be met, it should be the responsibility of individual TOs to put measures in place that work within the context of their business and corporate structure.

Obligations on conduct

4.15. We propose placing overarching obligations on the TO's conduct when completing preliminary works and providing information to bidders. The obligations will be put in the TO's licence and will make our expectations clear about the overall aim to mitigate conflicts of interest. The key obligations we think the TO should meet are:

1. To act in a way that does not give the TO bidding party, or any other party, an undue advantage over any other participants in the tender process.
2. To act transparently, making all relevant information available and clearly setting out the measures taken to mitigate conflicts of interest and protect sensitive information. As such we would expect the TO to sign a confidentiality agreement for participation in the tender.

3. To act efficiently when engaging in the tender process and to facilitate the process.

Business separation measures

4.16. While overarching obligations on conduct make the TO's responsibilities clear, they alone cannot provide sufficient confidence that TOs are restricted from acting on the conflicts of interest identified above. We consider that business separation measures are also required. There should be rules governing how parts of the TO preliminary works team, TO bidding party and other constituents of the TO interact with each other and how they make sure that no part of the business has an undue competitive advantage.

4.17. There are some **minimum requirements** which we think business separation measures must meet. These are:

4.18. **Information** – the TO should have systems in place to ensure that information it holds related to the preliminary works is protected and restricted. Specifically:

- The systems should be designed to ensure that the TO bidding party should access the information through the project data room, at the same time and in the same way as other bidders.

- These systems should include strict and robust rules governing the use of any shared information technology (IT) systems across TO preliminary works team TO bidding party and other relevant constituents of the TO, to ensure that access to restricted information is prevented. As a general principle we would expect separate IT systems may be needed, however, we would consider other similarly robust arrangements.

4.19. **Managerial** – there should be a clear division in management responsibility between the TO preliminary works team and the TO bidding party. TOs should propose an appropriate level based on their corporate structure, but we would expect there to be separation at least as far as TO board level and preferably at the parent company board level.

4.20. **Employee** – we propose there should be restrictions on employee involvement. Specifically:

- There should be no transfers of employees from the TO preliminary works team to the TO bidding party during a period running from: (i) a specified point before the project data room starts to be populated, through to (ii) an appropriate period after the tender has been completed.

- There should be clear rules governing the involvement of other employees (eg from other relevant constituents' of the TO) in the bidding process, that reflect the TO's obligations on its conduct.

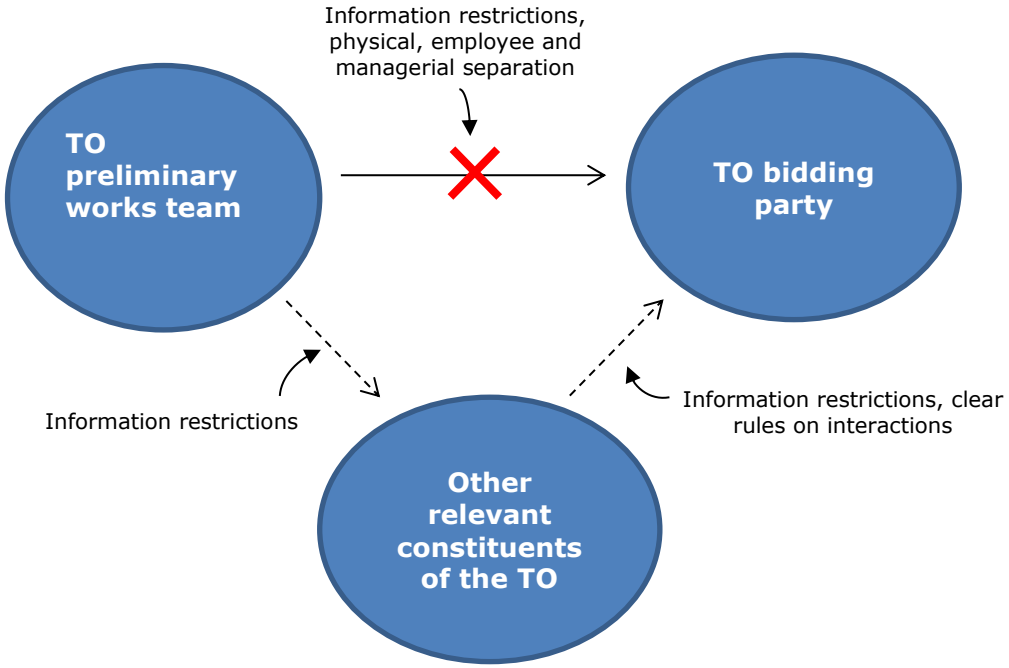
4.21. **Physical** – we propose that the TO bidding party operate from a separate physical location from the TO preliminary works team, either on separate premises or on separate parts of premises, with restricted access between locations.

4.22. **Financial** – the TO should ensure that costs incurred in relation to competitive tendering (including bid costs, and the costs of project construction and operations if appointed as a CATO) are not recovered from regulated revenue related to other activities or assets (eg RIIO-T1). Where there are different regulated revenue streams, the methodology should set out how they are being managed to ensure separation.

4.23. **Legal** – we believe that establishing a separate company as the TO bidding party would likely meet the requirements we have set out. However, we would consider a situation where bidding is from the within the TO company, if the TO's methodology demonstrates that our above requirements are met.

4.24. Figure 8 illustrates where we propose measures should be in place, and the relationship between different constituents of the TO.

Figure 8: Illustration of TO business separation



Scrutiny

4.25. The measures the TO has committed to will require scrutiny to ensure they are in place and effective. This can come from many sources: internal scrutiny from the TO or designated personnel, external scrutiny from us, or external scrutiny from an independent auditor or industry panel.

4.26. We think there should, at a minimum, be internal scrutiny by a person appointed by the TO to oversee its compliance with the conflict mitigation measures. This person should:

- be independent from the TO preliminary works team and TO bidding party.
- prepare a report on the measures put in place and how they achieve the overall obligations on the TO. We would receive the report and scrutinise the outcome.
- suggest any additional relevant measures to mitigate conflicts of interest effectively.
- have access to the resources needed to assess compliance.

4.27. There may also be value in having an independent party scrutinise and audit the arrangements the TO has in place. While the internal scrutiny is likely to identify any issues or shortcomings in the TO's compliance with the arrangements, independent scrutiny could provide additional assurance for us and other bidders. It would, however, add cost to the process, so we would want to be convinced that it brought significant additional value to the competitive regime. We are interested in stakeholders' views on this.

4.28. If TOs are found non-compliant, we have a range of possible remedies depending on the seriousness of the non-compliance. We could, for example, require the TO to change their processes. For more serious matters, we could consider whether it's appropriate for the TO or their associated business to continue participating in the competition.

Implementation, process and timing

4.29. We propose that TOs submit a **methodology** to us for approval before a tender. This should cover the steps the TO has taken in the three overarching areas of conduct, business separation and scrutiny. It should define the relationship between the TO preliminary works team, the TO bidding party and any other relevant constituents of the TO. It should also include a compliance statement and an undertaking on arrangements that will apply during the tender.

4.30. We propose the following stages for putting in place conflict mitigation measures:

- **Obligations on the TO** – we propose that general obligations in relation to participation in a tendered project should be put in place through a change to all the incumbent TOs' licences, which we will draft and consult on later this year, alongside other changes to reflect pre-tender arrangements.

- **Methodology agreed** – for each project that could be tendered in its area, the TOs should submit their methodology for addressing conflict mitigation measures to us for approval. We will assess it and request changes where appropriate. The methodology should be agreed as soon as reasonably practicable.

- **Measures in force** – the point where the conflict mitigation measures are in force for a project, and the TO preliminary works team and TO bidding party are separated with information restrictions and a prohibition on staff transfers. The timescale for these to be in force should be agreed as part of the methodology.

- **Pre-tender compliance report** – once the measures are in force, the TO should report on its compliance with the measures.

- **Post-tender compliance report** – the TO should report to us on its compliance with the measures at various stages throughout the tender process. The final report should be made once the preferred bidder stage is reached.

Conflicts of interest for other bidders

4.31. Other bidders could also gain an unfair advantage if they have prior knowledge or experience of the project to be tendered. An example could be where a bidder worked with the incumbent TO on preliminary works for the project.

4.32. For all bidders, we propose the following arrangements should apply, which mirror those we apply for OFTO tenders:

- Bidders sign a confidentiality agreement to gain access to confidential information.

- Bidders sign a 'conflicts of interest declaration' at the pre-qualification stage of the tender, declaring any existing or potential conflicts of interest.

- Where a bidder has highlighted particular conflicts of interest in making this declaration, we would ask for and assess information from the bidder on separation measures in place, which could include a memorandum of understanding.

4.33. If a bidder adds a new party to its bidding group at later stages of the tender process, we would expect the bidder group in its new form to be covered by a

confidentiality agreement and a conflicts of interest declaration. We would also expect to consider information on measures to mitigate any new conflicts of interest that adding the new party has given rise too.

4.34. If we are not satisfied that the bidder has mitigated conflicts of interest appropriately, we can disqualify the bidder.[32]

[32] Generic OFTO licence and guidance for Tender Round 4: https://www.ofgem.gov.uk/publications-and-updates/generic-ofto-licence-tender-round-4

Appendices

Alongside this document, we have published three supplementary documents – these can be found on our website.

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Appendix 1 – Consultation Response and Questions

1.1. We would like to hear the views of interested parties in relation to any of the issues set out in this document.

1.2. We would especially welcome responses to the specific questions which we have set out at the beginning of each chapter heading and which are replicated below.

1.3. Responses should be received by 22 July 2016 and should be sent to:

Joe Baddeley
Transmission Competition Policy
9 Millbank, London, SW1P 3GE
0207 901 7348
TransmissionCompetition@ofgem.gov.uk

1.4. Unless marked confidential, all responses will be published by placing them in our library and on its website www.ofgem.gov.uk. Respondents may request that their response is kept confidential. We shall respect this request, subject to any obligations to disclose information, for example, under the Freedom of Information Act 2000 or the Environmental Information Regulations 2004.

1.5. Respondents who wish to have their responses remain confidential should clearly mark the document/s to that effect and include the reasons for confidentiality. It would be helpful if responses could be submitted both electronically and in writing. Respondents are asked to put any confidential material in the appendices to their responses.

CHAPTER: Two

Question 1: What are your views on our proposed arrangements for asset ownership and responsibilities? In particular can you provide examples of specific scenarios where it may be necessary for ownership transfer of existing physical assets to occur between network operators?

Question 2: Do you agree with our proposed principles for packaging projects?

Question 3: Do you consider the processes we have set out for determining which projects to tender are appropriate?

Question 4: Beyond the NOA and the connections process, what other routes should we be utilising to identify suitable projects for competition, eg for non-load projects?

Question 5: What do you consider should constitute 'early development works' for options ahead of their assessment in the NOA process, ie what works should be undertaken in order to ensure that the most appropriate tendered options are developed for submission at the initial tender checkpoint?

CHAPTER: Three

Question 6: What are your views on the suggested process for carrying out the pre-tender roles?

Question 7: Regarding preliminary works and the tender specification:

- **(a)** What are your views on the scope of the baseline tender specification?
- **(b)** How likely is it that additional preliminary works will be required, and if so, what types of works are likely to be required?
- **(c)** What are your views on:
  - **(i)** The role of bidders in identifying the need for further information / additional preliminary works (eg additional independent surveys) to inform robust bid assumptions?
  - **(ii)** The most efficient process for enabling this?

Question 8: What are your views on the proposed arrangements for the data room and bidder clarifications?

Question 9: What are your views on our proposals regarding the funding of preliminary works and tender support activities in RIIO-T1?

Question 10: Do you have any initial views on risk allocation across the preliminary works party and the CATO?

CHAPTER: Four

Question 11: Do you agree with our proposed requirements for incumbent TOs to mitigate potential conflicts of interest, where they are both bidding for and developing a project in RIIO-T1?

Question 12: Is internal scrutiny of the arrangements the TO has in place to mitigate conflicts of interest sufficient, or would there be significant additional value in having an independent party scrutinise and audit the TO's arrangements?

Question 13: Do you agree with our proposal to manage conflicts for other bidders?

Appendix 2 – Feedback Questionnaire

2.1. We consider that consultation is at the heart of good policy development. We are keen to consider any comments or complaints about the manner in which this consultation has been conducted. In any case we would be keen to get your answers to the following questions:

1. Do you have any comments about the overall process, which was adopted for this consultation?
2. Do you have any comments about the overall tone and content of the report?
3. Was the report easy to read and understand, could it have been better written?
4. To what extent did the report's conclusions provide a balanced view?
5. To what extent did the report make reasoned recommendations for improvement?
6. Please add any further comments?

2.2. Please send your comments to:

Andrew MacFaul
Consultation Co-ordinator
Ofgem
9 Millbank
London
SW1P 3GE
andrew.macfaul@ofgem.gov.uk