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National Grid ESO

Delivered via email

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Dear Fintan,

ESO Early Competition Plan

In May 2019, we requested that the Electricity System Operator (ESO) to include an Early Competition Plan alongside its RIIO-2 Business Plan to be submitted in December 2019.¹ As part of this decision, we provided our minimum expectations as to what this plan should include.²

Further to this, we are sending this letter to provide further clarification as to what we expect to see in the ESO's Early Competition Plan.³

Purpose of this work

Early competition can help to generate a wide range of ideas for solutions to system needs, and these may bring net benefits for consumers. For these competitions to be effective they should be open to as many potential solutions as possible, including proposals from the full range of both network and non-network options.

To progress this, we need to do further work to scope early competition. For example, what are the underlying components, what are the roles and responsibilities of different industry parties and what would be needed to implement early competition?

The ESO's Early Competition Plan will help us to establish the next steps on early competition.

However, neither the RIIO-2 Sector Specific Methodology Decision (SSMD) in May 2019, nor this letter, represent a commitment to proceed with any part of the ESO's Early Competition Plan or the role of the ESO within any future early competition process.

Our expectations for the ESO's Early Competition Plan

We set out below what we consider the Early Competition Plan should include:

- A. A clear description of proposed early competition models
- B. Proposed roles and responsibilities of all parties in these early competitions models.

¹ See paragraphs 2.20, RIIO-2 Sector Specific Methodology Decision and further consultation – Electricity System Operator, Ofgem, 24 May 2019; <https://www.ofgem.gov.uk/publications-and-updates/riio-2-sector-specific-methodology-decision>

² For convenience, a copy of the paragraphs 2.20-2.30 of the RIIO-2 Sector Specific Methodology Decision and further consultation – Electricity System Operator is included in Appendix A to this letter.

³ In the case of conflict, this letter supersedes the original guidance provided in the RIIO-2 Sector Specific Methodology Decision and further consultation - Electricity System Operator with regard to the Early Competition Plan. Otherwise, the two documents should be read together.

We also set out our expectations regarding the plan's relationship with the ESO's RIIO-2 Business Plan and ESO's stakeholder engagement to support the development of the plan.

A. Clear description of proposed early competition models

The Early Competition Plan should cover the form and scope of at least two potential early competition models and should detail the associated processes and functions for delivering those competitions. The proposals should consider the whole lifecycle of the competition model, from project identification to tendering and post-tendering processes.

We expect these proposals to cover at least:

- an early competition model for the **design and delivery** of a solution
- an early competition model where the outcome of the competition is the design only, not the delivery of the solution (ie a '**competition for ideas**').

The early competition model for the **design and delivery** of a solution should be designed to enable entities with the legal and technical ability to deliver their proposed solution to submit tenders to compete. The aim is that the same model should be able to operate with and without Competitively Appointed Transmission Owner (CATO) legislation.⁴ For example, before CATO legislation is passed, solutions from existing licensees should be able to compete against options from parties able to deliver non-network solutions without the requirement for a licence. Should CATO legislation be enacted by Parliament, then the aim is that existing licensees, parties able to deliver non-network solutions that do not require a licence and those parties whose solution would require the issuance of a licence should all be able to compete to meet a system need.

The ESO should outline their view of criteria to determine which types of system needs are better suited to early competitions for design and delivery and those for designs only. In designing this criteria, we expect the ESO to consider the balance between the potential benefits of encouraging innovation and securing delivery at lowest cost.

For non-network solutions, the ESO should consider which party would be most appropriate as contract counterparty with winning bidder(s) and process that would be followed to establish the counterparty. As part of this, the ESO should consider the appropriateness of itself fulfilling the role of contract counterparty.

For either model, the ESO should consider how the proposed arrangements would allow for fair and transparent competitions. This should include how participants in the competition will have equal access to all the necessary information required to submit competitive bids, including for example relevant land surveys.

The ESO should also give explicit consideration of the role of data in their design, both how reform in data management can improve their performance and design of tender processes, and also how its operations should treat and share data for the benefit of the whole system. In this regard, the ESO should consult directly with the Energy Data Taskforce.⁵

B. Roles and responsibilities of parties under early competition models

⁴ Please note, that our references to the *Competitively Appointed Transmission Owner* (CATO) legislation should be read as any final legislation (however so named) which covers the underlying purpose of granting a licence following a competition in any network sector.

⁵ Further information about the Energy Data Taskforce is available here, <https://es.catapult.org.uk/news/energy-data-taskforce-report/>

The ESO should outline the proposed roles and responsibilities of all parties in these early model competitions at each stage of the competition, considering the most appropriate body to fulfil the roles.

As part of this, the ESO should consider the scope of its own possible role relating to the early competition models, including the practical implications of its role and responsibilities, including estimated cost, expertise and risk implications. When considering its own role, where in the ESO's view certain areas are outwith the ESO's legal remit, this should be explicitly identified together with potential solutions – including licence or legislative change.

The early competition model design should explicitly consider what role the ESO could play in supporting competition for solutions at the electricity distribution sector level from 2023 for RIIO-ED2, identifying which aspects of a competition process they may be able to provide (eg, auditing, running and/or assessing the tender process).

For clarity, the ESO should not focus its Early Competition Plan on the late competition models set out in the RIIO-2 SSMD.⁶ However, as part of the process for producing their proposals, the ESO should give consideration to potential conflicts between its proposed early competition models and the late competition models. The ESO should work with Ofgem to determine how to best manage the interactions between Ofgem's role and the proposed early competition models.

Interaction with ESO RIIO-2 Business Plan

This Early Competition Plan is distinct from the ESO's RIIO-2 Business Plan, and should be treated separately. The Business Plan should, however, reflect the potential content of the ESO's Early Competition Plan such that their RIIO-2 Business Plan can flex to meet the additional revenue and institutional requirements in the case that Ofgem decides to advance the ESO's early competition proposal(s). Importantly, the ESO should explicitly indicate which new roles or functions are not covered under existing revenue streams under RIIO-1 and prospectively under RIIO-2.

We intend to ensure any new roles in relation to early competition are built into the ESO's wider performance and incentives framework. The ESO should consider how its performance in delivering the proposed early competition models would be best measured through this framework. This includes identifying relevant outcomes, performance metrics and clearly defined and measurable deliverables. In light of this work, we will also consider whether any structural changes are needed to the incentives (for example to the ESO's roles and principles framework) as part of our final decision on the incentives for RIIO-2.

Stakeholder engagement

When developing the plan, the ESO should engage with relevant stakeholders and arrange workshops/working groups to ensure the proposals reflect a design which is practical and in the best interests of consumers. The ESO should also consider consulting on its emerging draft plan.

The ESO should also consider the governance that will oversee the development of this plan. As part of this, it should consider the role that may be played by existing stakeholders

⁶ By late competition, we refer to the Competition Proxy model, Special Purpose Vehicle model, and the Competitively Appointed Transmission Owner approach. See RIIO-2 Sector Specific Methodology Decision and further consultation – Electricity System Operator, Ofgem, 24 May 2019; <https://www.ofgem.gov.uk/publications-and-updates/riio-2-sector-specific-methodology-decision>

or stakeholder groups such as the the RIIO-2 Challenge Group and ESO RIIO-2 Stakeholder Group within the process process.

Next steps

We seek regular project updates from the ESO on this work. When considering project updates and emerging drafts from the ESO, we may seek to provide feedback or further guidance on the content of the Early Competition Plan and the way forward on early competition.

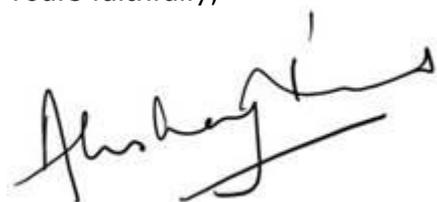
Appendix B sets out our expectations regarding the timeline for developing the Early Competition Plan. Together with the first project update in October, the ESO should agree with us the governance framework for this work.

The ESO should then submit a project update and a draft plan in December 2019 in line with the RIIO-2 Business Plan submission date. Within this project update, we are particularly interested in:

- i. What is already being undertaken to support a prospective proposal (eg. expansion of the Networks Options Assessment (NOA))
- ii. What can be set out and costed by December 2019 (eg. setting out what is being done in terms of competing for non-network solutions and any costs associated with expanding this further)
- iii. What remains to be scoped and costed beyond December 2019 (eg. the detailed form and scope of potential early competition model proposals).

Ultimately, we request that the ESO submit the Early Competition Plan to us by February 2021. Following its submission, we will assess the plan and decide on next steps on early competition.

Yours faithfully,



Akshay Kaul
Director, Networks Price Control

Appendix A: Paragraphs 2.20 – 2.30 of RIIO-2 Sector Specific Methodology Decision and further consultation - Electricity System Operator⁷

In Chapter 10 of the Core Document we explain that we are continuing to investigate and develop the ESO's ability and capacity to facilitate early competition, noting that the ESO is already required to report on its progress on facilitating timely, efficient and competitive network investments. To this end, as part of its RIIO-2 Business Plan to be submitted in December, we are requesting the ESO to include an Early Competition Plan.

In this Plan, the ESO must set out how it intends to develop proposals and arrangements for early competition. This should, at a minimum, include:

- the proposed scope and form of early competition, and the associated processes and functions for delivering those competitions, noting the ESO has proposed a two-phase approach in its consultation response. The processes could be usefully grouped as: (i) before the competition, (ii) the competition itself and (iii) post-competition processes
- identifying which early competition functions and capabilities the ESO is already undertaking or possesses, and those that would reflect a new skillset, function or capability for the ESO to obtain in order to support an expanded role in facilitating competition
- pathways and timeframes for achieving the ESO's plan to deliver early competition (including its development of skills, functions and capacities). Where development can occur against varying timeframes, these should be considered and their implications discussed. The ESO should be explicit around which aspects can be reasonably achieved prior to the commencement of RIIO-2 and which (for reasons of practicality or cost-effectiveness) should be delivered during RIIO-2
- the ESO's view on roles and responsibilities to support its proposed arrangements, including identification of other parties where appropriate. Where the view is that a particular role or responsibility is less appropriate for the ESO to undertake or develop, the steps or mitigations that could address this should be outlined
- the ESO's view on which legislative provisions and/or licence conditions would empower the ESO to undertake the identified functions
- the ESO's view on possible regulatory or legislative barriers to its proposed arrangements.

We are keen to work iteratively with the ESO as this work develops prior to (and after) December and the ESO should consider arranging workshops or working groups. This should not preclude the ESO consulting with its stakeholders, where doing so is likely to improve the quality of its Early Competition Plan. For the avoidance of doubt, the requirement for the ESO to develop an Early Competition Plan does not represent a commitment by Ofgem to proceed with any changes that it may recommend. We will consider its findings and recommendations, and consult further with stakeholders as appropriate, before deciding how to proceed.

We note the concerns from stakeholders around potential conflicts for the ESO. As we focus on developing the ESO's capability to introduce early competition into the electricity transmission system, we will continue to monitor whether the ESO exhibits sufficient independence from National Grid group and other National Grid businesses, as well as other potential biases.

⁷ Taken from paragraphs 2.20-2.30, RIIO-2 Sector Specific Methodology Decision and further consultation – Electricity System Operator, Ofgem, 24 May 2019; <https://www.ofgem.gov.uk/publications-and-updates/riio-2-sector-specific-methodology-decision>

In response to some stakeholder concerns, we note that, in addition to the new legal framework the ESO operates under, we have in place some mitigations for potential bias, including requiring three Sufficiently Independent Directors on the ESO Board, requiring an annual Compliance Statement and Report, instituting an ESO Compliance Subcommittee (chaired by one of the Sufficiently Independent Directors) and our review of developments since separation to be undertaken in 2020/2021. We will also continue to keep the need for further mitigation under review as these arrangements are developed further.

Finally, we note that depending on the outcome of the Competitively Appointed Transmission Owner (CATO) legislative process, we will need to consider the potential role of the ESO in facilitating some aspects of late competitions under the CATO model.

Appendix B: High-level expectations for developing ESO Early Competition Plan

Project milestone	Notes	Date
Project update	Including confirmed governance framework	October 2019
Project update / draft plan	Indicating: <ul style="list-style-type: none"> i) areas of work already being undertaken ii) incremental aspects of the draft proposal which could be delivered for commencement of RIIO-2 iii) components of the workstream which could potentially be delivered during RIIO-2 	December 2019
Project update		Q2, 2020
Project update		Q3, 2020
Submission of Early Competition Plan		February 2021