

# Early Competition Plan

Phase 3 Consultation: Chapter 2, Roles and Responsibilities

December 2020



# Contents

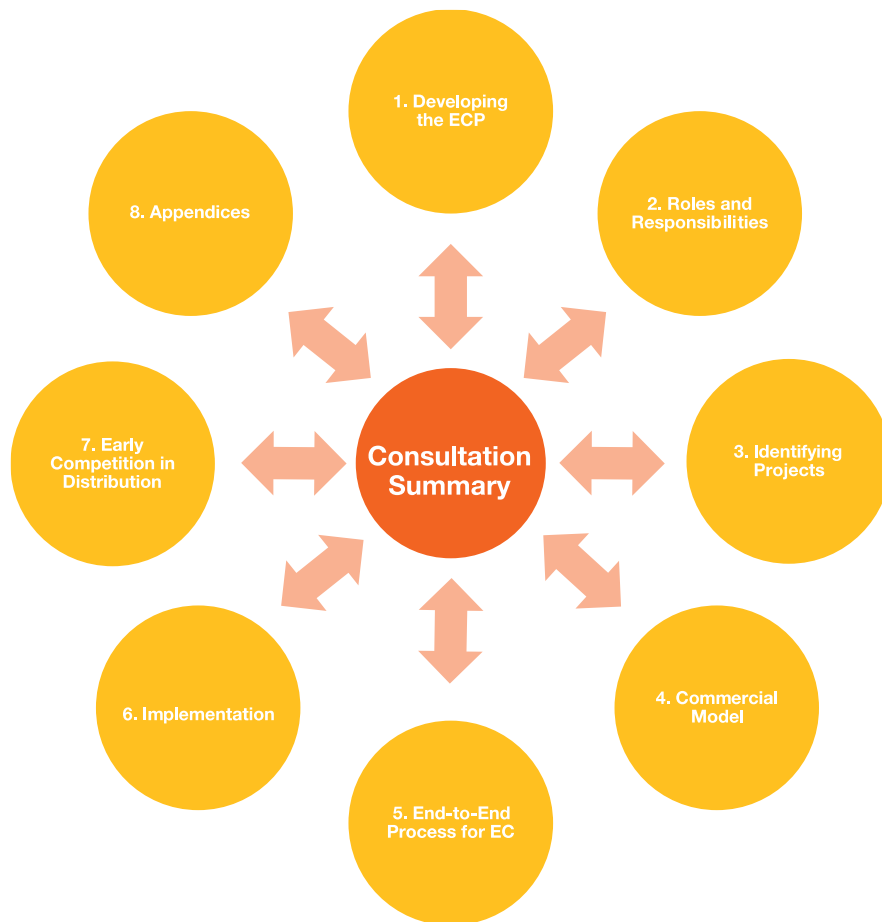
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# 1 Summary

This chapter focuses on Roles and Responsibilities under early competition and the development in our thinking from our Thought Paper published in September 2020.

In September 2019 Ofgem asked us to outline the proposed roles and responsibilities of all parties in early competitions. Including which bodies would be most appropriate to fulfil them and to consider our own role in supporting early competition.



In July 2020, we published our Phase 2 consultation on our proposals for the end to end model of early competition. Within this we set out our high-level views on what roles and responsibilities are needed to carry out early competition. We also considered which parties could be best at facilitating early competition.

Broadly, stakeholders agreed with the new roles identified in the early competition model. However, there were some concerns regarding the incumbent Transmission Owners ("TOs") participating in competitions as a market player. Therefore, we wanted to explore these views in greater detail ahead of our Phase 3 consultation to better inform our position.

[Our Thought Paper](#) on Roles and Responsibilities shared with stakeholders more information and considerations around each role consulted on in our Phase 2 consultation. Feedback from this paper and supporting workshops has then helped to inform our views for this consultation. This chapter summarises feedback from these workshops along with our current positions.

Following our Thought Paper, for this consultation we would like to explore and gain stakeholder's views on:

- Initial proposals for the role of the Approver
- Further considerations and options for the Procurement Body
- Proposals for both Contract Counterparty and Payment Counterparty roles
- Network planning roles and responsibilities, and
- Case study comparison

This is our current position and any final decisions on any of the proposals discussed in this paper will be subject to any legislation that is implemented.

This consultation paper proposes that National Grid ESO may be the most appropriate industry participant to perform one or more of the roles that will be required to implement the early competition model. This consultation paper sets out a proposed model. It should not be taken as an indication that the board and/or shareholders of National Grid ESO have consented to carry out specific roles or actions, other than the development of the model as requested by Ofgem. Certain parts of the model, such as the allocation of risk and reward for performing any specific role and the associated limitations on liability have not been fully clarified. When those parts of the model are finalised, and should Ofgem recommend that the ESO fulfil a particular role, the board and shareholders of National Grid ESO would then consider whether it was appropriate and able to take on the particular role or roles.

## 1.1 Overview of all roles and their interactions

This section gives an overview of the roles we are considering for early competition. We also try to bring together the proposed activities under each role and their interactions.



### Be transparent where possible

Following feedback from our workshops and from our Phase 2 consultation, we wanted to provide a more visual representation of our proposals.

In this section, we share some additional information that summarises our current view of how each role and their activities will interact with each other through each stage of early competition. Figure 1 aims to bring together all the activities we are proposing in our Phase 3 consultation and which entity will be responsible for delivering it.

### Roles

Following on from Phase 2 and our Thought Paper, we feel the following roles will best facilitate early competition:

#### *Procurement Body*

This entity will be responsible for the design of the procurement structure and process, the development of tender and contractual documents as well as management of the procurement process.

#### *Approver*

Makes the formal decision to conclude a stage of early competition.

*Licence Counterparty*<sup>1</sup>

This entity will manage and monitor the obligations placed on a winning bidder that is issued, or has, a transmission licence

Please note that our starting assumption (which has been supported by stakeholder feedback) is that Ofgem is the only party that can fulfil this role under current legislation (Electricity Act 1989). Therefore, we do not discuss this role further in our Phase 3 consultation.

*Contract Counterparty*

This entity will manage and monitor any obligations placed on a winning bidder who will hold a contract for any solution not performing the function of electricity transmission (non-network).

*Payment Counterparty:*

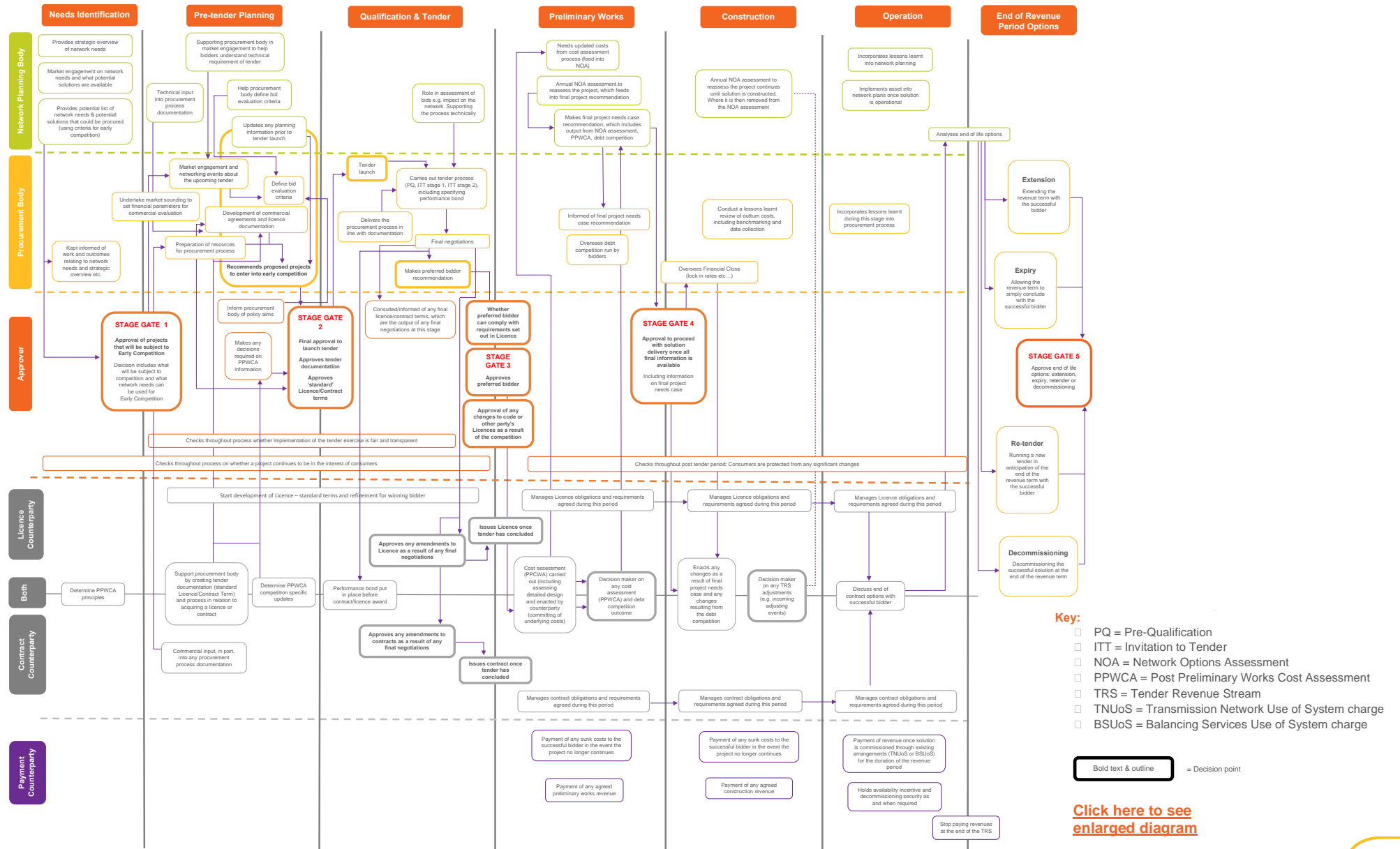
This entity will manage financial transactions between the winning bidder and the other counterparties.

*Network Planning*

Roles and responsibilities for network planning currently exist for Transmission Owners and the ESO. There are several different aspects to network planning such as boundary reinforcements, customer connections and asset health planning. The Early Competition Plan focuses mainly on boundary reinforcement planning.

<sup>1</sup> The Licence Counterparty will also manage and monitor any obligations placed on any other type of licensee (e.g. generators) as a result of an early competition.

Figure 1: Roles interaction map



## 2 Approver Role

This section aims to explore our initial proposals for the activities that sit under the role of the Approver and what this role entails. This is the first time we are sharing this with stakeholders.

**Ofgem is the most appropriate party to own the role of Approver in early competition**

### Stakeholder feedback

Following and supported by feedback from our Phase 2 consultation and September Workshops, we believe that Ofgem is the most appropriate entity to take on this role. In Phase 2 we noted that the entity undertaking this role would make a formal decision to conclude a stage of the early competition. We suggested two stages;

1. Confirming the need to be tendered, and
2. Selecting the preferred bidder and approving the contractual documents (if a non-network solution).

In developing our thinking, we have expanded on these two stages and created the proposals that follow in this chapter. In response to our consultation, stakeholders supported Ofgem holding this role.

As a key stakeholder for this role we have engaged with Ofgem on these proposals. The proposals remain the view of the Electricity System Operator ("ESO").

### Updated preferred option

Our preferred position is for Ofgem to oversee and approve stage gates throughout the end-to-end process due to the significance of the activities that take place throughout each stage. Giving bidders and stakeholders more comfort and confidence in the process. We also feel that this would be in the best interest of consumers to make sure the project continues to represent consumer value and that they remain protected from any significant changes. Figure 2 provides detail on where we see each stage gate occurring during the early competition process.



### Keep our stakeholders in the know

In our Thought Paper, we shared the feedback we received from our stakeholders and our belief that Ofgem is the most appropriate entity to take on this role, which stakeholders continued to support.

Figure 2: Approver role proposal

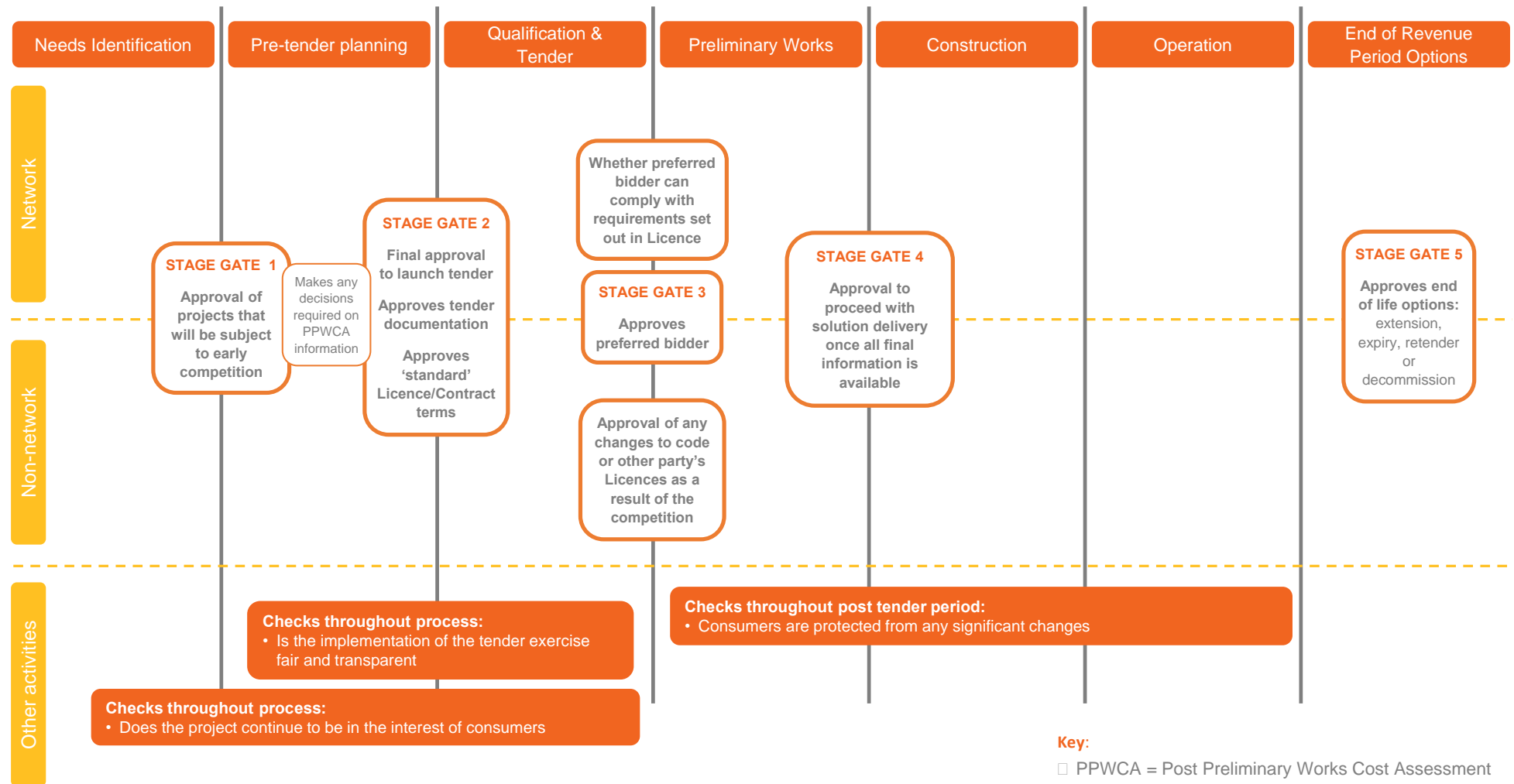




Figure 2 is a snapshot of the diagram referenced in Section 1.1. In the following narrative, we note wider activities from our larger map (Figure 1), carried out by other roles that impact the role of the Approver (Ofgem). Final decisions on these proposals are subject to any legislation that is implemented.

### *Stage Gate 1*

Under this stage gate, the Network Planning Body will conduct market engagement on network needs and the potential solutions available. The Network Planning Body will then provide Ofgem with a list of the potential network needs and solutions that could be procured (using criteria for early competition). Once this has been received, Ofgem will approve what network needs should be subject to early competition (they may also reject certain needs at this point).

### *Stage Gate 2*

Before this stage gate and during the Pre-Tender Planning stage, the counterparties (Licence Counterparty and Contract Counterparty) will be creating the Post Preliminary Works Cost Assessment ("PPWCA") methodology and guidance. The Licence Counterparty and Contract Counterparty will create and approve these documents. However, we propose that Ofgem could make any decisions required on the PPWCA information ahead of Stage Gate 2 (see [Chapter 4 - Commercial Model](#)).

Also, ahead of this stage gate, the Procurement Body will develop tender documentation (with support from the Licence Counterparty and Contract Counterparty) and prepare resources for the procurement process. They will also undertake further market engagement to make sure there is sufficient appetite to compete. Depending on the length of time this takes for a particular project, the Network Planning Body may also need to review whether there have been any changes to the need.

The Procurement Body will compile all of this information, including any outcomes from the Network Planning Body review, and submit this to Ofgem. This will allow Ofgem to make a decision on whether the tender should go ahead and give final approval to launch the tender. They will also approve the tender documentation provided and approve 'standard' Licence and contract terms.

### *Stage Gate 3*

This stage gate is where Ofgem approves the preferred bidder. Following the completion of the procurement process, the Procurement Body will:

- Make sure the bids meet the evaluation requirements
- Recommend the preferred bidder to Ofgem

Once receiving the preferred bidder recommendation, Ofgem will conclude the tender exercise by approving or rejecting the preferred bidder. Following this (depending on the preferred bidder solution) the Contract Counterparty would issue a contract, or the Licence Counterparty would grant a Licence.

If the winner is a network solution, Ofgem would also approve whether the preferred bidder can comply with the requirements set out in the Licence. For a non-network solution Ofgem would approve (subject to appropriate consultation) any project specific changes to Codes or other party's Licences as a result of the competition.

### *Stage Gate 4*

This stage gate occurs at the end of the Preliminary Works stage and will represent the approval to proceed with solution delivery once all final information is available. This information would be provided by the Network Planning Body and supported by the relevant Counterparty. Information provided by the Network Planning Body in relation to the final project needs case will be submitted to Ofgem. This information includes output from the Network Options Assessment ("NOA") and conclusion of the PPWCA and debt competition. All of this information will inform Ofgem's decision whether the solution is still needed and is in the best interest of the consumer.

If a disapproval is found at this stage, Ofgem itself would instruct the relevant Counterparty to exercise the termination provisions set out in the relevant contract or Licence. For more information on this process, see [Annex 1 - Heads of Terms](#).

#### Stage Gate 5

The final stage gate is situated at the end of the Operational Phase, where the End of the Revenue Period Options are assessed. We are proposing four options at this stage; extension, expiry, re-tendering or decommissioning (see [Chapter 5, Section 11](#)). Once these options have been considered, a recommendation will be made to Ofgem, who will approve or reject the option presented.

We have not yet finalised which roles will be involved in each end of life option. However, we will share more information when this is available.

#### Other Activities

These are activities that Ofgem will carry out as Approver. They will occur over more than one stage of early competition as shown in Figure 2.

- **Check at specified milestones whether a project continues to be in the best interest of consumers**- This activity would occur from needs identification stage up until the end of the Qualification & Tender stage (Stage Gate 3)
- **Checks on whether the implementation of the tender exercise is fair and transparent** - This activity would occur throughout the procurement process. During this activity there may be an option of a third-party providing a type of independent quality assurance activity. Please see Section 3 of this paper for more information on this option, and
- **Checks to make sure that consumers are protected from any significant changes** - This will occur between Stage Gates 3 and 5.

We are still working on the detail of what these checks would look like and involve.

#### Questions

1. Do you agree with the activities of the Approver we are proposing and why?
2. What do you think the checks, that make up the other activities, should look like? Should they be a formalised process?

### 3 Procurement Body

This section aims to explore the role of the Procurement Body further, taking on feedback we have received from stakeholders following our Thought Paper published in September and subsequent workshops.

#### Phase 2 Consultation and Thought Paper

In our Thought Paper we analysed the options proposed in our Phase 2 consultation of different entities owning the role of Procurement Body. From Phase 2, those entities were Ofgem, a Third Party (meaning a party other than Ofgem, the Electricity System Operator ("ESO") or an incumbent TO) or the ESO. We heard mixed feedback from stakeholders and wanted to explore this further in this consultation.

At a high level some of the key activities that we see the Procurement Body carrying out during different stages of early competition are as follows:

- *Pre-tender planning* - market engagement, preparation of tender documents and developing recommendation of proposed projects to enter into early competition
- *Qualification & Tender* - Carries out the tender process, any final negotiations and makes a preferred bidder recommendation
- *Preliminary works* - oversees debt competition
- Stages following this are mainly lessons learnt activities to help inform future procurement exercises

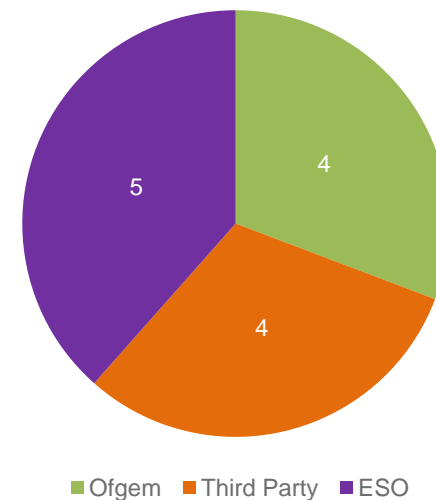


#### Be transparent where possible

Across both of our workshops, as well as having valuable discussions on this role, we polled stakeholders on the question "Who do you think is best placed to carry out the Procurement Body role?".

#### Stakeholder feedback

Figure 3: Who do you think is best placed to carry out the Procurement Body role?



As illustrated by Figure 3, there was an even split amongst stakeholder views on who should own the Procurement Body role. We heard from stakeholders that it would be helpful to have more information and detail on the Procurement Body role. There was also feedback regarding whether the Procurement Body was acting on behalf of another entity/body and what Licence/regulatory changes would be needed. At present we are still considering the specifics around these points, but we set out our high-level assumptions of changes that may need to be made.

There was also a concern raised during a workshop that data management is a crucial risk for the Procurement Body role. This is due to the volume of commercially sensitive data involved in the process, that needs to be managed. Please see [Chapter 5 Section 3](#) for more information on how we propose to address this risk during the procurement process.

Lastly, there was a view from stakeholders that there could be a mix of parties carrying out the procurement process which we would like to explore further within this chapter.

### **Be transparent where possible**

We consulted on all these activities as part of our Thought Paper where we received no specific concerns from stakeholders about each activity listed. Only that stakeholders would like more information around the role as a whole, as they felt the role was not fully defined, regulatory changes were unknown, and it was unclear if the procuring body were acting on behalf of another entity.

### **Updated preferred position regarding further clarity on the Procurement Body role**

At the start of this section we set out the high-level activities that we see sitting under the Procurement Body. Our preferred position on the detail of the Procurement Body is set out in the Figure 1 Roles interaction map, which aims to help put the activities sitting under the Procurement Body in context for early competition as a whole. It also represents what aspects we see the entity undertaking this role carrying out, whilst linking these to the other proposed roles.

The activities under the Procurement Body are dependent on work we have been undertaking as part of our Pre-tender and Tender workstreams. [See Chapter 5, Sections 2, and 4 to 7](#) where more specific information about these activities can be found.

Some stakeholders raised specific points around the Procurement Body as an entity, how it is set up and whether it will be procuring on behalf of another body/entity. This is something we cannot confirm at present. Discussions are on-going with Ofgem and BEIS, about the regulatory and legal arrangements that could surround this role. We have however developed some initial views on potential regulatory changes irrespective of who takes on the role. These are set out in Table 1..

Table 1: Initial views on potential regulatory changes for the Procurement Body role

| Estimated magnitude of regulatory changes | Initial view of changes to facilitate role  |
|---|---|
| Moderate to High                          | Depending on the final procurement process, new legislation and subsidiary documentation may be needed. This could be followed by Entity (if they currently hold a Licence) and TO licence changes (or the potential of a new Licence for a third party), consequential changes to System Operator Transmission Owner Code ("STC") and STC Procedures (such as data, disputes and new process). Minor consequential change to the Connection and Use of System Code ("CUSC") dependant on remuneration route. |

Please note these are initial views and will be refined once we know which entity or entities will be carrying out the Procurement Body role and any regulatory arrangements that surround early competition.

We have also begun considering what resource would be needed to deliver this role. Figure 4 shows the resource capability we think would be needed for the Procurement Body role. This skillset would either need to be within the procuring body itself or contracted in for the competition

Figure 4: Procurement Body capability

|  |                                |   |                                    |
|--|--------------------------------|---|------------------------------------|
| Procurement specialists                | Engineers (civil, electrical)  | IT systems and support (management and assurance, data portals) | Risk qualification and analysis    |
| Licence and Permitting specialists     | Project management             | Health, safety and environment resource                         | Commercial management              |
| Commissioning and Interface specialist | Financial and Cost specialists | Legal advisor   | Communications and Events planners |

## New Issues for consultation

### Would the involvement of multiple parties in the procurement process work?

A point was raised at our workshops that we had not previously considered, elements associated with the procurement process could be shared across different entities. Therefore, we wanted to explore this option further.

#### Phase 2 Consultation and Thought Paper

In Phase 2 we proposed some high-level responsibilities of the Procurement Body. We also noted at the time that we believed this role could be fulfilled by Ofgem, a Third Party or the ESO.

When considering the Procurement Body in our Thought Paper, our suggestions focused on one entity carrying out the procurement process. As mentioned earlier, the options proposed for the Procurement Body were Ofgem, a Third Party or the ESO.

#### Stakeholder feedback

We heard from stakeholders that the activities of the Procurement Body could be a combination of the proposed entities. It was discussed in our [Roles and Responsibilities Thought Paper](#) that this approach could mitigate some of the disadvantages identified whilst leveraging some of the advantages. It could also give greater confidence in the process than if one party carried out the whole procurement process.

We also heard that a mixed approach has been used in other parts of the world such as Asia and Latin America. Here System Operators run the competition and the regulators set the procurement process, basic requirements, oversight rules etc. This approach was intended to overcome the fact that no one had ever designed such a model before and has been met with approval from potential investors. There was also a suggestion that a Third Party could provide quality assurance of the procurement process to provide bidders with additional assurance.

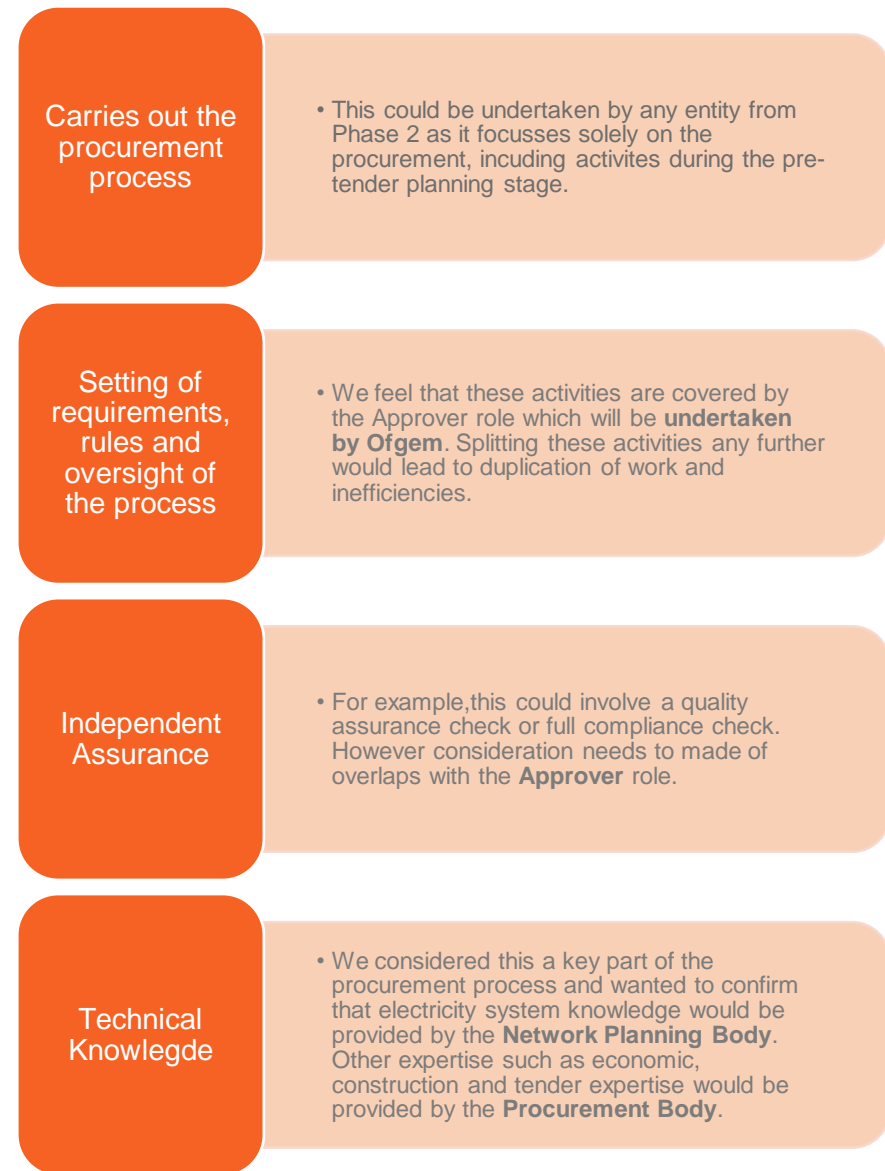
However, we also heard that there is a risk that the regulator could be over involved in the process leading to time delays in the process. There was also a general concern on roles that having too many parties involved may create additional complexity in interactions through early competition.

**Update**

In approaching this feedback, we considered the key activities involved in the procurement process and possible activities raised by stakeholders, then considered the practicality of these options. We have reviewed this internally and any views on our assumptions would be appreciated. Our findings are set out in Figure 5..

We then looked at the entities we proposed during Phase 2 and in our Thought Paper. We still believe that either Ofgem, a Third Party or the ESO can carry out the Procurement process.

Figure 5:Key activities involved in the procurement process



### Independent Assurance

As noted above this activity could have significant duplication with the Approver role being carried out by Ofgem. Therefore, we propose (but not limited to) three possible high-level approaches for this role:

- Quality assurance of the procurement process as a whole
- Quality assurance of aspects of the procurement process, for example the evaluation of bids (Quality Control)
- A compliance check of the whole process against regulations/ legislation/regulatory arrangements

**We are seeking feedback on whether the activity of independent assurance is needed**

When looking at these approaches alongside our proposals for the Approver role, we think that the first two bullet points, where a variation of quality assurance is provided, could be viable. As the purpose of quality assurance is to provide confidence that quality<sup>2</sup> requirements will be fulfilled, this could provide additional assurance for participants in the early competition process.

<sup>2</sup> Quality assurance as defined by International Standards (ISO 9000) is "part of quality management focused on providing confidence that quality requirements will be fulfilled".

However, the Approver will be performing activities such as:

- Ensuring that the tender process has been fair and transparent
- Ensuring that the project is in consumer interests
- Ensuring that consumers are protected from changes

These activities will occur throughout stages of early competition, however what they look like is to be confirmed. These activities imply some form of assurance or quality checking to fulfil their intent.

At present we do not think the independent assurance activity is needed, however this is subject to agreeing the Approver role with Ofgem.

### Our preferred position

Our preferred position is that independent assurance of the early competition procurement process by a third party is not needed.

In Section 2 (Approver Role), we detail the activities we envision sitting under the Approver role which will be carried out by Ofgem. We feel these activities are sufficient to make sure the Procurement Body is compliant with the procurement process. We also believe that as per current industry practices, Ofgem is the industry independent regulator and so can carry out these activities in an objective manner in the best interest of consumers.



### Keep our stakeholders in the know

This role will also be dependent on any regulatory arrangements that are put in place and the potential for these to impact the procurement process. Therefore, following the submission of the Early Competition Plan to Ofgem in 2021 and the subsequent work undertaken by Ofgem, this role can be further defined.



It is our current view that requiring quality assurance would be a duplication of activities carried out by Ofgem in its role as Approver (namely making sure the tender process has been fair and transparent). Therefore, an independent assurance activity would add time and cost to the process and deliver no additional benefit for consumers.

After taking on board responses to this consultation, we need to consider the liabilities, risk and remuneration framework. This may help provide further clarity for which entity or entities is best placed to undertake this role.

### Questions

3. Who do you think is the most appropriate party or parties to own the Procurement Body role?
4. Taking into consideration the role of the Approver, do you think an Independent Assurance activity is needed?

## 4 Contract Counterparty Role

In this section we reflect on stakeholder feedback regarding this role and provide an update on our position. Please note this role focusses on non-network solutions only and that this section should be considered in conjunction with [Annex 1 - Heads of Terms](#).

We are proposing the outcome of the tender process is either a transmission licence for network solutions or a contract for non-network solutions. As such the role of the Contract Counterparty is only applicable to non-network solutions. As these solutions will not perform the function of transmission a transmission licence would not be needed. This does not mean that the winning solution may not need (or already have) another type of licence, such as a generation licence (for more information see [Chapter 4 Section 4.1](#)). From our engagement in September we heard three key messages in relation to this role.

- The need for this party to make sure there is a level playing field (as far as possible) with network solutions
- Whether we could consider the possibility of a hybrid arrangement of different entities performing this role
- That there could also be some benefit in combining some roles (across early competition)

From the feedback received, to make sure there is fairness and transparency, there needs to be a balance in aligning contract obligations fairly versus network solution obligations. The entity performing the role owning will need to be fully conversant with the liabilities and risks associated with the role. We also heard a recurring theme following on from the discussion on the Procurement Body, that there would be benefits to some of the roles being combined or run by a single entity. This would mean fewer interfaces and parties involved overall in managing the whole process. This would lead to less time needed to manage interactions between parties and less handovers needed during the process.

A stakeholder asked why Ofgem was not considered for this role. We did not propose Ofgem for this role because at present Ofgem is not the Contract Counterparty for any non-network solutions and would changes to primary legislation to allow Ofgem to recover potential costs of being a counterparty from industry. Therefore, we did not feel they would be an appropriate party to fulfil this role.

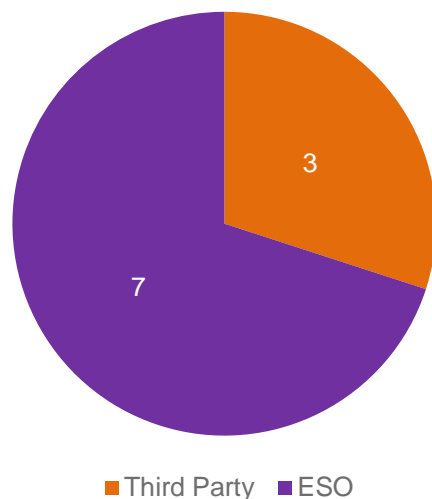


### Keep our stakeholders in the know

During our workshops in September, as well as having valuable discussions on this role, we polled stakeholders on the question "Who do you think is best placed to carry out the Contract Counterparty role?"

As illustrated by Figure 6 there was majority support for the Electricity System Operator ("ESO") carrying out this role.

Figure 6: Who do you think is best placed to carry out the Contract Counterparty role?



### What is our minded to position?

Taking on board all stakeholder feedback and analysing this role in more detail, we, as the ESO, are minded to propose that we take on the role of Contract Counterparty. This is subject to the implementation of an appropriate remuneration, risk and liability framework and subject to the finalisation of the contracting arrangements surrounding early competition.

#### Phase 2 Consultation and Thought paper

In Phase 2 we gave a high-level summary of the role and stated that we believed either a third party or the ESO could undertake this role. In our Thought Paper we analysed the advantages and disadvantages of a third party or the ESO taking on this role.

From our initial assessment, some advantages we found were that the ESO has experience of contracting, there is the potential for less additional funding needed for this role, it would build on existing capabilities and the ESO has experience of working with some

potential bidders through balancing services procurement. However, the complexity of the contracting arrangements we are proposing under early competition is different to our standard contracting arrangements.

We also discussed the advantages and disadvantages of a third party taking on this role. Here we discussed one advantage a third party brings is it is an independent body so there would be no perception of conflicts of interest during certain processes. However, disadvantages included

possible high set up costs, the need to acquire the relevant skills and experience and potentially higher monitoring costs from Ofgem.

Once these had been presented, there was majority support for the ESO taking on this role.

**Risks**

In looking at the risk in more detail, we think that one of the biggest risks with this role relates to the complexity of the contracting arrangements ([see Annex 1 - Heads of Terms](#)). Our current proposals differ to current contracting arrangements undertaken by the ESO. Early competition will introduce a Post Preliminary Works Cost Assessment ("PPWCA") ([Chapter 4 - Commercial Model](#)), carried out by the relevant counterparty, which is something that is not currently done by the ESO. However, to mitigate this, the counterparty and/or Ofgem can produce an agreed, transparent, robust cost assessment methodology that bidders are made

aware of during the pre-tender planning stage (see Figure 1 Roles interaction map).

We are trying to align contract obligations to Transmission Licence obligations, where appropriate, this could increase the monitoring and management resource needed for each contract (potentially to the extent that Ofgem manages licensees). We are also proposing arrangements such as 'income adjusting events' to be included in an 'Early Competition Contract'. These arrangements could increase the risk of disagreements on cost changes etc. However, subject to the right remuneration and the ability to gain the right resource and skills, these key risks could be mitigated.

We have also developed some initial views on potential regulatory changes irrespective of who takes on the role. These are set out in Table 2.

Table 2: Initial views on potential regulatory changes for the Contract Counterparty role

| Estimated magnitude of regulatory changes | Initial view of changes to facilitate role  |
|---|---|
| Low to Moderate                           | Depending on what legislation and licence changes are defined for the procurement process, it may lead to updates or creation of a new commercial services agreement. Including overarching Entity Licence updates. |

**The ESO is minded to propose to that we take on the role of Contract Counterparty, subject to some conditions.**

**Our preferred position**

Our preferred position is that we take on the role of Contract Counterparty for early competition. However, this will be subject to the implementation of an appropriate liability, risk and remuneration framework. It will also be subject to the final contracting arrangements to make sure that counterparty rights and obligations are appropriate. We propose some draft heads of terms in [Annex - 1 Heads of Terms](#). We will also review our position as and when these are finalised. We welcome your feedback on these positions.

## Questions

5. Do you agree with our position on the Contract Counterparty role and why?

## 5 Payment Counterparty Role

In this section we summarise the feedback received from stakeholders during our September workshops and share a minded to position on who should perform this role.

This role manages the financial transactions between the winning bidder and the other counterparties. We propose that these financial transactions follow current charging arrangements ([see Chapter 5 Section 10.1](#)). Therefore, we are proposing that network solution costs are recovered via Transmission Network Use of System Charges ("TNUoS"). For non-networks solutions, we propose costs are recovered through Balancing Services Use of System ("BSUoS") charges. The recovery of costs via TNUoS and BSUoS charges is currently carried out by the ESO.

### What did our stakeholders say?



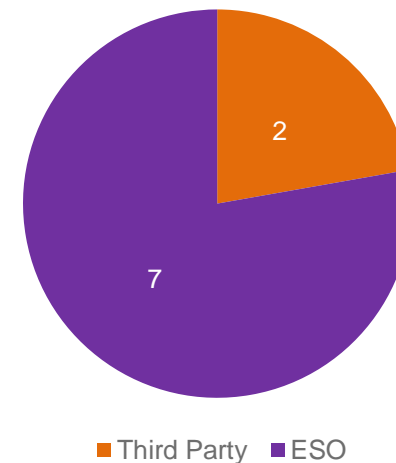
#### Keep our stakeholders in the know

During our September workshops we discussed risks associated with this role and the advantages and disadvantages of either a third party or the ESO taking on this role.

We received limited feedback during these discussions on who should perform this role. Some stakeholders noted the TNUoS/BSUoS under and over recovery disadvantage we raised would be applicable to any entity that took on the role. One stakeholder raised a point that we should consider whether the Payment Counterparty could hold the decommissioning security and be responsible for releasing them back to the contractor.

Further to the valuable discussions on this role, we polled stakeholders on the question "Who do you think is best placed to carry out the Payment Counterparty role?". As illustrated by Figure 7 there is a clear majority for the ESO carrying out this role.

Figure 7: Who do you think is best placed to carry out the Payment Counterparty role?



## What is our minded to position?

Taking on board all stakeholder feedback and analysing this role in more detail, we, as the ESO, are minded to propose that we perform the role of Payment Counterparty. This is subject to the implementation of an appropriate remuneration, risk and liability framework and subject to review if current charging arrangements change.

### Phase 2 Consultation and Thought Paper

In Phase 2 we gave a high-level summary of the role and stated that we believed either a Third Party of the ESO could carry this role. In our Thought Paper we analysed the advantages and disadvantages of a third party or the ESO taking on this role.

When looking at a third party, some advantages identified were:

- They are potentially able to provide greater financial security than under current arrangements e.g. if Government backed
- There is a proven model that works, for example with the Low Carbon Contracts Company ("LCCC")

However, there are also disadvantages:

- This entity could require high set up costs
- The need to build up the knowledge of current payment arrangements
- The need to have an acceptable credit rating to carry out the role, and
- Existing arrangement for TNUoS and BSUoS would need to be amended to facilitate a third party, which may lead to a delay in implementing early competition

Following this discussion and feedback noted on the previous page, there was overall support for the ESO to carry out this role.

We have also received feedback relating to who pays each charge and whether it is appropriate that these parties differ for network and non-network solutions under current charging arrangements. We have highlighted this to Ofgem and believe that this is a wider question and out of scope for this project.

### Risks

We discussed general risks around liquidity, that the length of contracts may impact regulatory arrangements to recover costs and a potential increase in the volume of disputes relating to amounts due or paid. We also mentioned a high-level risk of the impacts of work undertaken by wider industry on charging arrangements having a consequential impact on our proposals.

We have also developed some initial views on potential regulatory changes irrespective of who takes on the role. These are set out in Table 3.

Table 3: Initial views on potential regulatory changes for the Payment Counterparty role

| Estimated magnitude of regulatory changes | Initial view of changes to facilitate role   |
|---|--|
| Low                                       | Consequential amendments to CUSC and STC depending on remuneration and payment approach for roles. |

### Our preferred position

Our preferred position is that we take on the role of Payment Counterparty for early competition. However, this will be subject to the implementation of an appropriate liability, risk and remuneration framework. It will also be subject to review if charging arrangements change. We welcome your feedback on these positions.

**The ESO is minded to propose to that we take on the role of Payment Counterparty, subject to some conditions.**

### Questions

6. Do you agree with our position on the Payment Counterparty role and why?



## 6 Network Planning Bodies

In this section we focus on how existing roles and responsibilities for network planning may need to be adapted in order to accommodate competition. Specifically, we set out our view on Transmission Owner ("TO") participation within competitions and consequential conflicts of interest that arise from their existing network planning roles.

In our Phase 2 consultation, we set out our view that incumbent TOs should be able to participate in competitions, and that they should do so through the same bidding process as other participants. We also highlighted that further consideration was needed around conflicts of interest between TO participation and their role in network planning. We now set out further views on these conflicts.

### Network planning roles and responsibilities

There are several different aspects to network planning, such as boundary reinforcements, customer connections and asset health planning. The Early Competition Plan focuses mainly on boundary reinforcement planning, often referred to as 'the NOA process'.

Both the ESO and TOs currently have a role in the NOA process. The ESO assesses potential future energy demands, models the network boundaries and analyses the costs and benefits of build solutions. The outputs of these activities are published in the Future Energy Scenarios ("FES"), Electricity Ten Year Statement ("ETYS") and the NOA respectively. Figure 8 presents this process.

TOs also play an important role in this process. As the network owners and operators, they help make sure the modelling accurately reflects their networks. They develop the build solutions to be considered in NOA and they also find non-build solutions by utilising their existing assets differently (such as changing ratings). As the ESO does not build or own transmission assets, expertise on these areas does not sit in the ESO.

Recently, this process has been expanded to enable third parties to propose solutions for analysis in the NOA, through the Interested Persons Options process. In [Chapter 3 of our Phase 3 consultation](#), we set out further thinking on how this might develop in future to support stakeholders to engage with the early stages of solution development.

**The Interested Persons Options process, introduced this year, aims to increase the diversity of option considered within the NOA process.**

For early competition, we need to consider whether any changes are needed to which parties should undertake those activities.

Figure 8: the boundary reinforcement network planning process



### Phase 2 consultation

In our Phase 2 consultation we consulted on our position that incumbent TOs should be able to participate in competitions in the same manner as other bidders, providing suitable conflict mitigation arrangements are put in place. At that point, we did not set out our view on what conflict mitigation would look like. We provide further detail on this in this consultation (see 'new issues for consultation' below).

### Stakeholder feedback

In response to our Phase 2 consultation, we received a mixture of views on this point, with differing perspectives. One TO and two potential bidders agreed with the proposal. Two TOs disagreed. One potential bidder had concerns about TO participation in any form.

One TO believes that if TOs participate as market players, they will be taken outside the realm of the regulatory framework in which they are designed to operate. They feel this regulatory framework make sure energy security, affordability and carbon and greenhouse gas emission reductions are achieved. Another TO did not foresee any benefit of a TO participating within competitions through the same process as other bidders as it believes it is obliged under acts/codes, to present the most economic and efficient solution to address network needs. Both felt that TOs should develop solutions through their existing regulatory processes and frameworks to provide a counterfactual. A competition should be run alongside this with bidders needing to beat the counterfactual.

One TO felt that the incumbent TO should be able to bid into the competition process as any other market participant to ensure effective competition from potentially value adding participants. The incumbent TO must also have the option not to compete if it does not wish to do so.

One potential bidder agreed that the incumbent TOs should be able to compete as it is an open and transparent market. However, they felt that the TOs have significant advantages that need to be addressed, including connection process, energy cost, cost of capital, user charges and land & development rights.

Another potential bidder, however, felt market interest is likely to therefore be lowered by TO involvement and that the use of competition reflects a view that TOs are not the best option. They note that regulators in other sectors have excluded incumbents. They argue that TOs should not be able to bid because:

- TO assets have already been paid for by consumers and should be made available for market solutions
- Some of the capabilities, paid for by consumers, are difficult for the market to replicate, and
- There is a risk of cross-subsidisation.

A TO also felt that the incumbent TO should not be the 'TO of last resort' for projects which are not appealing to the market.

In our subsequent Role and Responsibilities webinars, the views above were reiterated. A potential bidder also suggested TOs should be limited to competing outside of their geographical area.

We also received one response following our Thought Paper, from a TO. They emphasised the points made in our Phase 2 consultation and of the significance of this matter for TO businesses. They also highlighted that TO regulatory solutions should be retained and not compete against commercial solutions. They reasoned it is fundamental that incumbent TOs' proposed network solutions are treated as the 'counterfactual' in order to demonstrate if competition is delivering benefit.



### Keep our stakeholders in the know

Given the stakeholder interest in TO participation in early competition, we discussed this Issue In depth with our Electricity Networks Stakeholder Group ("ENSG").

#### Updated preferred option

Our preferred position is that incumbent TO participation in early competition could help deliver consumer value. The TOs are well placed to deliver competitive bids which benefit consumers due to their expertise in delivering such projects and will therefore increase competitive pressures. Incumbent TOs also have the potential to utilise their existing assets within their bid, which would not be the case if the TO's parent company participates through a separate entity. Overall, a competition should only be run if other bidders feel they could potentially offer a better value solution than the incumbent TO.

We also continue to think that TOs should participate in the same process as other bidders. This is the most straight-forward way to ensure equitable treatment of bidders.

We believe that TOs participating as a 'counterfactual' would present a number of challenges, stemming from the differences between the RIIO regime and potential competitive regimes. Examples include:

- Post-tender cost change mechanisms - in order for the process to be fair TOs would need to be limited to the same price change restrictions as the competitive process
- Service period - the service period requested in the tender could be different to the asset lifespan assumptions under RIIO. This will make fair comparison of proposals challenging
- Accounting for costs - in order to assess the true costs of bids all TO costs would need to be clearly accounted for. Therefore, any costs associated with developing proposals being competed would need to be separated from other RIIO costs, and
- Incentives and obligations - the incentives and obligations applied to a competitive tender may be different to the RIIO framework given that most bidders will be single transmission asset owners rather than incumbent TOs. This could affect the costs of the proposals.

Overall, we agree with the feedback that the regulatory and competitive regimes are fundamentally different. Hence, we therefore believe that running a competition that seeks to fairly compare the two different regimes would add complexity and challenge to the process.

Furthermore, the counterfactual approach would limit TOs ability to tailor their own bids, as they would have to adhere to their RIIO arrangements. This may restrict TOs' abilities to compete effectively.

It also would not provide a valid counterfactual as the cost of the TO solutions change over time as the solution is designed and consented. (The TO counterfactual would need to be halted before consenting as stakeholders have previously told us it would not be appropriate to consent two proposals as this hampers the consenting process.) This means the counterfactual is not accurate. Additionally, the counterfactual will not

necessarily be a true reflection of what would have been prepared under the regulated regime, as it will have been prepared with the knowledge that other parties could submit a lower cost option.

This approach would also incur significant duplication of cost for consumers if the TO counterfactual were paid for through RIIO.

## New issues for consultation

In this consultation we set out our proposed position on the conflict mitigation arrangements needed as a result of TO participation in competition.

### TO role in network planning

TOs currently play an important role, alongside the ESO, within the NOA process. TOs support the need identification, developing initial solution proposals and progressing those solutions through further design. TOs will have therefore prepared a solution design to any contestable network need as part of the network planning process, utilising RIIO funded resource, and so will have an advantage in starting the competition.

In addition to this role, TOs perform other network planning roles, including customer connections, asset health replacements and compliance driven reinforcements.

Stakeholders are concerned that TOs could influence the initial solution design, and so in turn, the tender specification, such that either projects are removed from scope for competition or favour particular solutions. Furthermore, TOs are likely to have access to additional network information not necessarily available to other bidders. TOs will also play a support role in the competition process, such as providing information about existing assets.

Some stakeholders are concerned that TO involvement in network planning could advantage a TO proposed solution.

Ofgem considered conflict mitigate as part of their [late model development work](#). For those conflicts they concluded that conflict mitigation measures were required within TOs.

Additionally, within the early competition process, prospective solutions will need to interface with existing networks. The impact of those solutions on the existing network will need to be assessed and considered in determining the suitability of the solution. Some solution types will require connections to the network, the practicalities and cost of this will also need to be assessed and factored in to the tender evaluation. TOs undertaking these assessment roles would therefore have access to competitors' proposals.

## Stakeholder views

In response to our Phase 2 consultation, potential bidders highlighted that there is a potential for conflict of interest if TOs identify solutions to system requirements that may then be competed. One potential bidder felt that TOs could, for example, leave solution development too late to run a competition. They also questioned whether TOs have the right expertise in identifying solutions given the increasing development of offshore renewables and associated infrastructure, integration with distribution networks and service provision from third parties, none of which the TOs are responsible for. Another potential bidder expects TOs to be able to deal with these projects with fire walls between their projects arm and their contracting arm. But felt that such separation of responsibility should be formalised.

One TO felt that no conflict mitigation is needed if they provide a counterfactual solution and that conflict mitigation measures would impose additional cost compared with an existing process. They felt that the potential of ringfencing a TO's network or system planning function will significantly impinge on their ability to plan the network and subsequently meet their legal and regulatory obligations. They feel that such a fundamental change must be subject to appropriate risk and impact assessment. They also strongly disagree with the notion of a transfer of responsibilities as the ESO does not hold information, knowledge or experience relating to the intricacies of the networks and their respective stakeholders.

We also discussed the role of the TO in our two Roles and Responsibilities webinars in September. During those webinars two potential bidders emphasised concerns about TOs being part of competitions and the conflict of interest with network planning roles.

This included concerns about cross-subsidising RIIO activity and competitive activity. It also included concerns that TOs could shape the initial solution, which to some extent gives them a strategic advantage. Similar concerns were expressed in bilaterals we held.

Individual stakeholders also highlighted the following points:

- The ESO should have greater technical understanding and not be reliant on TOs when assessing network needs and requirements
- In some comparable competitive models for delivering transmission assets some countries, such as Peru, have introduced separate planning bodies. These bodies are independent of both the transmission owners and system operators to ensure neutral network planning, and
- all of these issues would be best addressed by a full independent (in ownership terms) ESO.

In response to our Thought Paper, a TO fed back that they feel existing regulatory provisions already provide sufficient conflict mitigation, including provisions in the Utility Contract Regulations ("UCR"), Electricity Act, TO licences and industry codes.

Potential options considered

**Option 1**

**ESO undertakes all network planning**

Many of the conflicts would be removed if the ESO were to undertake all network planning. However, it would also present a number of challenges. Firstly, transferring this responsibility to the ESO would require a significant increase in resource and capabilities within the ESO. TOs would continue to have planning responsibilities for connections, asset health and for progressing non-competed boundary reinforcement projects. Resources will therefore need to be retained in the TOs. This option would also result in some planning activities happening in the ESO and some in TOs with potential reduction in synergies.

Furthermore, removing TOs from boundary reinforcement planning would reduce the ability of the TOs to plan their own networks. Given that the TOs maintain and operate their networks, they possess additional insight into how existing networks could be utilised more effectively, such as changing operational settings. It would be difficult to transfer all of this knowledge to the ESO. TOs will also be responsible for building and operating any reinforcements that are not competed.

**Option 2**

**TO role continues and bidding teams are ringfenced**

TOs, who own and maintain the networks, continue to have a role in planning those networks, capturing the benefits lost in option 1. Licence requirements would be introduced requiring TOs to introduce conflict mitigation arrangements. These arrangements would essentially ringfence the team preparing the TO's bid. Measures would be put in place to make sure they do not have access to additional information, additional bid preparation time or other bidders' information.

Under this option, the ESO would also need to play a strengthened role in reviewing TO proposed solutions in order to make sure they've considered the full range of potential solutions. This would include the ESO engaging with the market to seek potential alternative possible solutions.

However, this option does mean that TOs continue to have a role in network planning, which some stakeholders feel presents a conflict of interest.

**We propose that the role of the ESO should be strengthened to provide greater challenge of TO proposals**

### Preferred position

Our preferred position is that TO's should continue to play the current role in network planning and that their bidding teams should be ring-fenced (Option 2).

Some stakeholders have expressed that option 1 is needed in order to provide bidders with confidence that TOs do not have an undue advantage in the competition. We believe that conflict mitigation arrangements can be put in place to address any advantages TOs may gain from its network planning role. We recognise that some stakeholders feel that such conflict mitigation arrangements are not sufficient to provide confidence the competition is fair. However, we believe that the relevant conflicts can be mitigated and the alternative option (option 1) would require significant changes in roles and responsibilities and we feel this is disproportionate to the perceived risk.

To address the concerns that TOs could influence the initial solution design in a way that favours itself, we propose a strengthened challenge and review role for the ESO. This would include the ESO seeking views of stakeholders. Further detail on this stakeholder process is set out in [Chapter 3, Section 2.3](#).

The ESO already does some challenge and review of TO options, and this year the introduction of the Interested Persons Option Process began to seek stakeholder input. However, the ESO's current expertise does not extend to challenging, for example, build timescales. We propose that the ESO would need additional resource and capabilities in such areas in order to meaningfully undertake such a role, for example, project delivery expertise. This would allow the ESO to undertake more extensive challenge of TO proposals such as challenging TO delivery dates and proposing different solutions or technologies. It will also allow the ESO to

integrate third party solutions in to the overall package of solutions. The ESO's role would also involve repackaging TO proposed solutions such that they meet the competition criteria. For example, separating out an element of a solution that are 'new and separable' from the elements which are not.

We propose that TOs be required to introduce conflict mitigation arrangements for its bidding teams. We also propose that these requirements would be similar to those set out by Ofgem for late model competition. Further details can be found in their [consultation response](#), but in summary, these arrangements are:

**We propose that TO bidding teams should be ringfenced**

- Managerial separation of the bidding team from the TO.
- Strict rules in place around IT access to prevent TO bidding teams accessing information related to planning functions.
- The bidding unit must not comprise any employees of the TO who are involved in the planning works.
- Some physical restrictions to access to shared TO facilities.
- Bidding teams are not allowed to recover their costs from regulated revenues.
- Information relating to tender support undertaken by the TO must not be shared with the bidding team.
- The TO must confirm its intention to bid and begin to implement conflict mitigation arrangements within eight weeks of the initial approval of projects that will be subject to early competition.

## Questions

7. Do you agree with our proposed approach to conflict mitigation?



## 7 Case Studies

In this section we aim to provide background information on some precedents that have been raised by multiple stakeholders. These are on the Thames Tideway Tunnel project and the Contracts for Difference regime. We consider the roles under each example, and how these compare to our proposals under early competition and whether there are any lessons we can learn from these precedents.

The Thames Tideway Tunnel project and the Contracts for Difference regime are large procurements that have taken place in the utilities sector where several different parties have assumed different roles. Given these shared characteristics with early competition and feedback from our stakeholders we have explored the case studies to understand the extent to which they are appropriate benchmarks for early competition.

### Thames Tideway Tunnel ("TTT")

- The TTT project is the £4.2bn upgrade of the London sewer network, expected to complete construction in 2023
- The project is for major, bespoke infrastructure which is vital to London's future and a priority for both the Government and Ofwat
- Given the exceptional risks of the TTT project the Government considered it would not be financially viable to potential bidders without strong government support
- Thames Water ran the procurement process to select the Infrastructure Provider (IP), Bazalgette, with Ofwat oversight and acts as Payment Counterparty to Bazalgette
- Thames Water also procured and novated three construction contracts to Bazalgette
- Thames Water recovers the costs related to its Procurement Body and Payment Counterparty roles from its consumer bills, as part of a separate price control for TTT with its own incentive package
- Thames Water will also collect from its consumers TTT's revenue on behalf of Bazalgette

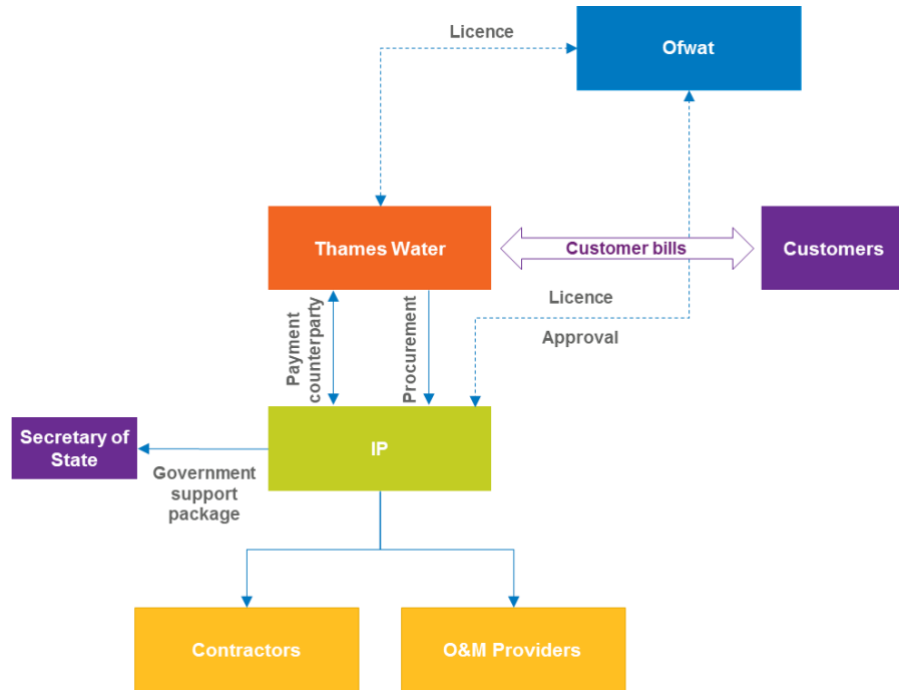
Table 4 indicates which entity carries out each role in the TTT project.

Table 4: Roles in the TTT project

| Role                                      | Entity       |
|---|--------------|
| Procurement Body                          | Thames Water |
| Approver                                  | Ofwat        |
| Licence Provider                          | Ofwat        |
| Payment Counterparty                      | Thames Water |
| Government Support Package (GSP) Provider | Government   |

These roles as well as the funding flows are set out in Figure .

Figure 9: Structure of the TTT project



We consider that TTT differs from early competition on several aspects which limits the lessons we can learn for the purposes of developing the model for early competition. We set out these key differences in Table 5.

Table 5: Key differences between early competition and TTT

| TTT   | Early competition                               | Key differences   |
|---|---|---|
| Thames Water is akin to Transmission Operator | ESO is the System Operator                      | Thames Water's role in the water sector is more similar to the role of a Transmission Operator than to the ESO because it is an asset owner and operator.   |
| TTT is a very late tender model               | Early competition is an early tender model      | TTT was primarily a financing competition whereas early competition is a design, build, finance, operate and maintain model.  |
| TTT is underpinned by a strong GSP            | Early competition is not expected to have a GSP | The Treasury has agreed to provide substantial support to Bazalgette in the event of certain risks materialising. Although early competition has high risk, it is not expected to benefit from a GSP. |

## Contract for Difference ("CfD")

- CfDs are long-term contracts to provide low carbon generators with price certainty over the lifetime of the contract
- To date, there have been three allocation rounds with a total allocated capacity of 15.4GW
- The ESO, as the Electricity Market Reform ("EMR") delivery body, runs the competitive tender process to appoint the bidders that will be awarded a CfD. Its Procurement Body role is funded through TNUoS
- The Low Carbon Contracts Company ("LCCC") is an independent, not-for-profit company set up by the Secretary of State for BEIS to play the role of Contract and Payment Counterparty with low carbon generators in the CfD scheme
- The LCCC forecasts and collects in advance levies from suppliers to make sure it has adequate funding to settle and clear CfDs (Supplier Obligation Levy and Total Reserve Amount) as well as to cover its operational costs (Operational Cost Levy)
- The LCCC recently accessed an interest free loan from the Department of Business, Energy and Industrial Strategy ("BEIS") to help fund projected shortfalls in supplier levies receipts. This will be repaid at a later date using levy funds collected from suppliers
- If a supplier fails to pay and there is insufficient credit cover in place to cover the full amount of the levy, the failure is socialised between the remaining suppliers. However, this situation has never happened so far.
- The LCCC returns to suppliers any unutilised Total Reserve Amount and Operational Costs Levy that exceeds its requirements

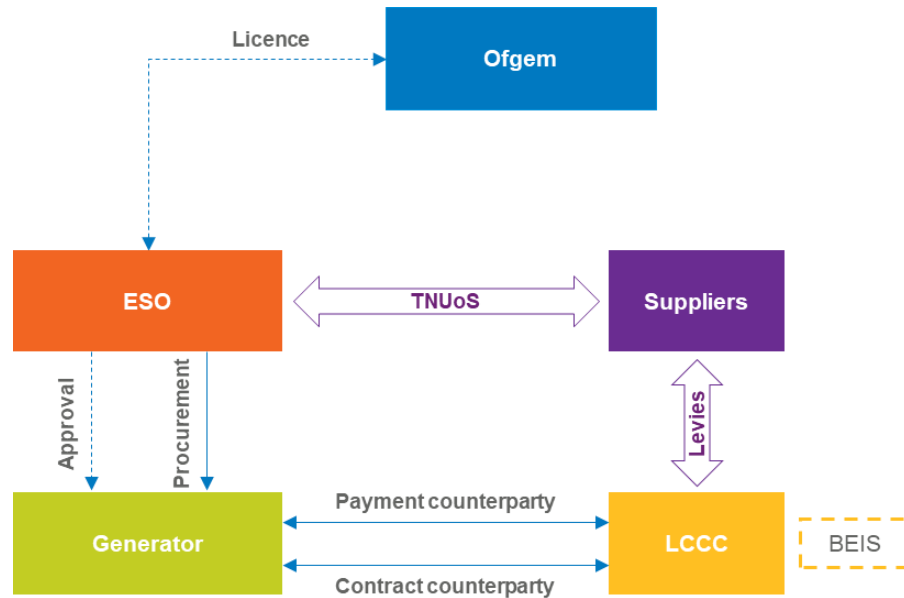
Table 6 indicates which entity carries out each role in the CfD scheme.

Table 6: Roles in the CfD scheme

| Role                  | Entity |
|-----------------------|--------|
| Procurement Body      | ESO    |
| Approver              | ESO    |
| Contract Counterparty | LCCC   |
| Payment Counterparty  | LCCC   |

These roles as well as the funding flows are set out in Figure.

Figure 10: Structure of the CfD scheme



We consider that there are several differences between the CfD scheme and early competition which are set out in

Table 7. As a result this limits the lessons that can be applied to early competition from the CfD scheme.

Table 7: Key differences between early competition and CfD

| CfD   | Early competition   | Key differences  |
|---|---|--|
| Payment Counterparty role faces significant uncertainty | Payment Counterparty role is not expected to be as uncertain                | It is expected that under early competition bidders would bid under a TRS model. However, under the CfD scheme, CfD payments are dependent on the difference between the electricity price and the CfD strike price, and as a result could demonstrate greater volatility.   |
| CfD scheme has a prescriptive procurement process       | Early competition is an early tender model and so more subjective in nature | Under the CfD scheme bidders are purely bidding for a guaranteed minimum payment which they will receive once their asset is operational. However early competition will assess bidders on the solutions they propose and their ability to deliver these solutions as well as to determine the entirety of their revenue stream. |
| Government owned companies undertake roles              | Government owned companies are not expected to undertake roles              | The LCCC is a government owned company and performs the Payment and Contract Counterparty roles under the CfD scheme. Early competition is not expected to involve government owned companies.   |
| ESO plays the Approver role                             | Ofgem plays the Approver role   | Unlike what is proposed for early competition, Ofgem does not play the Approver role in the CfD tender process. Ofgem only has a role in the dispute resolution process if bidders challenge the ESO's decisions.  |

## Questions

8. Do you agree with the key differences between early competition and these case studies, and that the key differences would limit the lessons that can be learnt for the purposes of developing the model for early competition?

## Next Steps

Thank you for taking the time to read this chapter of our Phase 3 consultation. We look forward to receiving your feedback which will help inform the final version of the Early Competition Plan. For full details on the range of options on how to respond, please refer to the [Consultation Summary](#).