

Response submitted via email to:
Box.earlycompetition@nationalgrid.eso.com

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Contact / Extension

Stephanie Anderson
0141 614 1581

Dear Early Competition Team

Early Competition Plan: Phase 2 Consultation (the “Phase 2 Consultation”)

This response is from SP Transmission (**SPT**), the onshore transmission owner (**TO**) for the South of Scotland. We note that, since the Phase 2 Consultation makes no reference to electricity distribution network-related matters, neither SP Distribution plc nor SP Manweb plc are providing any comments on the Phase 2 Consultation. However, as the ED2 Sector Specific Methodology Consultation refers to the ESO’s Early Competition Plan (**ECP**) and the potential role of early competition in electricity distribution, SP Distribution plc and SP Manweb plc will respond, in due course, on the ECP as the ESO develops the ECP further and expressly includes proposals relating to electricity distribution networks.

We have been actively involved in the development of the ECP to date and welcome the opportunity to share our views on the ESO’s latest proposals. In general, we have fundamental concerns with the scale of the ESO’s latest proposals, particularly given the significant impact these proposals will have on licensed network operators’ abilities to develop and maintain an economic, efficient and coordinated network across GB. These concerns run throughout the Annex to this letter, which contains SPT’s responses to the consultation questions posed by the ESO in the Phase 2 Consultation.

In addition to our responses in the Annex to this letter, we have the following overarching comments:

The ESO’s role in the development of early competition policy

We acknowledge that Ofgem has requested the ESO to develop the ECP. This is set out in various documents, for example, in the RIIO-2 Sector Specific Methodology Decision relating to the ESO, the letter dated 24 September 2019 from Ofgem to the ESO (**Ofgem’s Letter**) and the ESO Roles and Principles Guidance. However, most importantly from SPT’s perspective (and as Ofgem has noted in the recent RIIO-2 Draft Determinations Core Document, dated 9 July 2020) Ofgem must also undertake its own formal and substantive consultation on early competition. In doing so, Ofgem must comply with its statutory obligations and its own consultation policy.

In Ofgem’s Letter, Ofgem states that it expects the ESO to include proposed roles and responsibilities of all parties in the early competition models it describes in the ECP. We note that the ESO makes

SP House, 320 St Vincent Street, Glasgow. G2 5AD

Telephone: 0141 614 5213

www.spenergynetworks.co.uk

SP Transmission plc, Registered Office: Ochil House, Technology Avenue, Blantyre, G72 0HT Registered in Scotland No. 189126 Vat No. GB 659 3720 08
SP Manweb plc, Registered Office: 3 Prenton Way, Prenton, CH43 3ET Registered in England and Wales No. 2366937 Vat No. GB659 3720 08
SP Distribution plc, Registered Office: Ochil House, Technology Avenue, Blantyre, G72 0HT Registered in Scotland No. 189125 Vat No. GB 659 3720 08

some suggestions in the Phase 2 Consultation in response to this but also comments that this is a matter for its next consultation (Phase 3) on the ECP. In the Phase 2 Consultation, the ESO is proposing fundamental modifications to a number of existing TO roles, together with an expansion to the scope of its own role. Such proposals amount to a significant change to the existing regulatory regime, which we believe should be being taken forward by Ofgem and not the ESO. As explained below, we do not believe, that the ESO has either the licensing powers or regulatory responsibility for early competition.

Ofgem's guidance on the ESO's Roles and Principles seeks to set out the ESO's interpretation of this guidance through mapping against the ESO's Standard Licence Condition C16. In that, the guidance seeks to map the ESO's early competition role against C16(1)(e) and the ESO's responsibility to "[publish] information which the licensee holds to enable electricity market participants to make efficient operational and investment decisions". The ESO's proposals, as described within the consultation, go far beyond publishing information, in order to enable market participants (which include the TOs) to make efficient operational and investment decisions. The ESO's proposals also go beyond its licence obligation to "co-ordinate and direct the flow of electricity".

Any consultation by the ESO on the proposed scope of the roles and responsibilities of parties involved in early competition models must be consistent with the ESO's licence and the existing regulatory regime. Until that regulatory regime is modified, Ofgem is the appropriate party who should be undertaking this consultation exercise, given its potential impact on the TOs' licence obligations.

Impact on TOs' licence obligations to develop and maintain an efficient, co-ordinated and economical system

For the TOs, the ESO's proposals not only impact upon the TOs' licence obligations, but also significantly risk undermining the TOs' general duties under Section 9 of the Electricity Act 1989 where it is the duty of each licence holder to "*develop and maintain an efficient, co-ordinated and economical system*" of electricity transmission. As we understand them, the ESO's proposals could potentially involve the shifting of certain network planning responsibilities from TOs to the ESO. This would risk significantly impacting TOs' ability to comply with their licence obligations to properly co-ordinate the system and ensure it operates efficiently and economically.

Furthermore, careful consideration is needed of the potential impact of the TOs' and ESO's obligations under the System Operator Transmission Owner Code (STC). For example, the TOs have the responsibility to "*plan, develop, operate and maintain its Transmission System*". The ESO's proposals risk adversely impacting the TOs' ability to, amongst other things, plan and develop its own transmission system. This in turn risks becoming a compliance issue given the TOs' (and the ESO's) obligation to comply with the STC at Standard Licence Condition B12.

Impact on delivering consumer value and achieving Net Zero

We question the extent to which the ESO has assessed their current proposals in line with which solutions will deliver best value for the consumer. Delays to project delivery seem inevitable due to the complexity of tendering and awarding/negotiating of contracts/licenses, in addition to the delays associated with the bringing into effect of any necessary legislative change. Such delays are likely to be costly to consumers and generators alike, and risk undermining the UK's ability to meet its Net Zero targets on time.

The removal of any value threshold for projects to be delivered via early competition models

The proposal to have no value threshold on projects, potentially subject to delivery via an early competition model, makes network and business planning for TOs increasingly challenging and in fact introduces further uncertainty for investors. Ofgem identified the £100m threshold as a key criterion for projects potentially eligible for late competition. This threshold was calculated as the point at which consumers will continue to benefit from projects delivered via late competition models i.e. where the additional costs for tendering etc. are outweighed by additional consumer benefits.

The proposal to have a no value threshold is a significant departure, on the ESO's part, from existing processes and assessments and we question how the ESO can be confident that consumer benefits can be derived from the delivery of projects, via early competition models, regardless of the value of the project in question. We welcome sight of the Impact Assessment exercise that the ESO has undertaken to justify this proposal that a project value threshold is no longer in GB consumers' best interests.

We also note in Ofgem's RIIO-2 Draft Determinations Core document that as part of its consultation on the ESO's Early Competition Plan proposals, Ofgem will set out its views *"on any appropriate criteria for identifying projects for delivery through early competition, including whether or not £50m is an appropriate cost threshold for early competition"*¹. It is therefore surprising to us that the ESO is proposing the removal of any value threshold, whilst in the future, Ofgem intends to consult on whether a threshold of £50m continues to be appropriate for early competition.

The inclusion of a clear value threshold as part of the early competition criteria is key. The uncertainty as to which of a network operator's pipeline of future network projects will potentially be subject to delivery, via an early competition model, will undoubtedly affect investors' view of GB network operators as being stable, predictable regulated entities. This will in turn affect investor

¹ Ofgem RIIO-2 Draft Determinations Core Document, July 2020, paragraph 9.2

appetite to invest in GB network infrastructure, at a time when significant investment is needed to facilitate the UK, Scottish and Welsh Governments' Net Zero ambitions.

TOs to participate as market players

TOs participating as market players takes us outside the realm of the regulatory framework within which we are designed to operate. With the potential for early competition winners to be subject to different licence provisions (if they have a licence at all) compared to those of the incumbent TOs for network operations, these proposals have the potential to dilute the strength of the existing licence obligations which effectively operate and maintain the resilient GB-wide network. This regulatory framework has been carefully designed over an extensive period of time to ensure energy security, affordability and carbon and greenhouse gas emission reductions is achieved.

We continue to hold the view that in order to guarantee additional consumer benefit, compared to the status quo arrangements, it is fundamental that the incumbent TOs' proposed network solutions are treated as the 'counterfactual' against which all market bids can be measured. In order to be confident that additional consumer benefit is being delivered, it is fundamental that the ESO and Ofgem work together to develop transparent and robust Cost Benefit Analysis processes which, accurately and fairly, measure the consumer value and system benefits of long-term regulated network assets, against potentially shorter-term market solutions.

Need for a skilled workforce to operate the GB network

We are concerned that the ESO's proposals will simply increase competition across the UK for an already scarce and highly skilled workforce. This risks significantly weakening the TOs' ability to retain a highly skilled workforce to operate and maintain the GB network, in light of other network build opportunities which might be available from market players. Following the recent COVID-19 pandemic, we consider this is a time when the focus should be on accelerating further job creation as opposed to competing for skilled expertise already in the sector.

Please find our detailed response to each of the consultation questions in the annex that follows.

Yours sincerely



Stephanie Anderson
Policy and Economics Manager
SP Energy Networks

SP House, 320 St Vincent Street, Glasgow. G2 5AD

Telephone: 0141 614 5213

www.spenergynetworks.co.uk

Annex: SPT Response to Consultation Question

1. Do you agree with the types of drivers of network needs that should be within the scope of the ECP?

The ESO asks whether we agree with the types of drivers for network needs, however we understand from the consultation that the ESO will only consider these network needs *“once [its] proposed process is further developed”*. Our comments below are therefore subject to the ESO providing more detail around what its further developed process will entail.

The ESO notes it will consider, once the proposed process is further developed, how that process may need to be adapted to work with other drivers of network investment. We understand “other drivers” to mean other than where the ESO identifies major network reinforcement from its annual Future Energy Scenarios (FES). The ESO should clarify if this is what is meant and whether it intends that major network reinforcement, that it identifies from its annual FES, should be within the scope of the ECP.

Schemes considered for early tendering should be those that are less likely to impact time critical projects or the replacement of existing assets. In general, we do not consider customer connection or asset replacement projects to be suited to inclusion within the scope of early competition.

2. Do you think a tender launched ‘early’ (i.e. after an indicative solution has been identified) but informed by market engagement that begins ‘very early’ is a suitable process?

We agree an ‘early’ tender rather than a ‘very early’ tender is more practical, taken forward at the stage the network need has been confirmed and network solution proposed.

A proposed solution could be influenced by multiple network drivers. A ‘very early’ tender is less likely to generate efficiencies by considering multiple drivers to meet a particular network need during the design phase. This is something that TOs do as part of their usual planning cycle, as there is normally an inter-dependency between solutions that must be addressed in network planning studies. This also supports our position that an ‘early’ tender would be the more practical option.

However, the detail of how and when an ‘early’ tender should be launched and what it should contain needs further consideration and assessment.

We note from page 22 of the consultation that *“Bidders would not be required to adhere to any of the features of the indicative solution”* as highlighted in the NOA process. However, if bidders are not required to adhere to any of the features of the indicative network solution, it is not clear to us what is being tendered for, and how this differs from the ‘very early’ competition approach. In turn, it is not clear how this would lead to a *“less complex evaluation”* as suggested on p23 of the

consultation document, when bidders do not have to adhere to the features of the indicative network solution.

There is no indication given as to how long the tender process and licence award process may take, prior to survey work and initial design commencing, nor how this may impact the NOA process itself, including the project's Earliest in Service Dates (EISDs). If EISD's are to be delayed to accommodate early competition processes, the risk of early and sub-optimal decision making will need to be recognised fully in the Impact Assessment and Cost Benefit Analysis of the project. We also note on page 25 of the consultation document that *"stakeholders expect there to be a significant period of engagement prior to the tender launch"* and this will need to be taken account of in any tender programme.

We would welcome further details on what the ESO means by 'market engagement' as detailed on page 24 and how the ESO envisages this engagement working in practice. In addition, we would query whether this 'market engagement' can be considered as a sufficiently robust exercise that the market solutions, which the ESO identifies, can realistically be introduced into the NOA process.

We also question the current ability of the ESO to be able to undertake the work associated with such 'market engagement'. It is essential that the ESO considers and addresses the level of engagement that this will entail for the ESO and ensures that it is properly skilled and resourced to undertake such engagement, without substantial investment from Ofgem and, in turn, consumers.

3. Have we identified the appropriate criteria to determine whether to compete a project?

For bidders and network operators alike, it is important that the early competition criteria are clear, unambiguous and transparent. This is key for network operators in understanding what, if any, of their future projects could potentially be subject to early competition models. We address each of the proposed criteria, in turn, below:

(i) Market appetite

As outlined above, we welcome further details on how the ESO intends to gauge market appetite and whether it has the skills and resources to do this. We do not consider this to be a suitable criterion in the early competition criteria as it is unclear and subject to significant ambiguity, as to what is considered to be 'market appetite'. In order to provide network operators and market players with certainty, it is key that the criteria must be clear, transparent and unambiguous. We do not believe this to be the case with the proposed 'market appetite' criterion.

(ii) Certainty of network need

We agree that certainty of network need is an important criterion that should be included in the early competition criteria. Fulfilment of this criterion will ensure that tenders are only taken forward for identified network needs. This is another reason why 'early' competition, rather than 'very early'

competition, is the more appropriate framework, as the later timing of early competition will ensure that the network need is better understood.

(iii) New and separable

We agree that the criteria of new and separable are fundamental in identifying projects suitable for potential delivery by a third party. Both terms are clear and unambiguous and have worked well in the identification of projects potentially eligible for delivery under Ofgem's late competition framework. We therefore agree that new and separable should both be included in the early competition criteria but that for clarity and consistency, the terms should reflect those set out in Ofgem's Guidance on the Criteria for Competition², which are as follows:

New:

- A completely new transmission asset or a complete replacement of an existing transmission asset.

Separable:

- 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.
- The System Operator 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.

(iv) Absence of a value threshold

We are fundamentally opposed to the absence of a value threshold within the early competition criteria. This gives network operators no certainty as to what projects could potentially be eligible for delivery via early competition models, making network planning and regulatory business planning impossible. We note that this approach is also counter to Ofgem's RII0-2 Draft Determination Core Document which states that when Ofgem consults on early competition, following receipt of the ESO's ECP in February 2021, it will seek views on whether £50m is the appropriate cost threshold for early competition. A value threshold must be included. We would suggest £100m in line with late competition, given that Ofgem undertook Impact Assessment work to determine that £100m was the point at which consumer value could still be delivered, despite extra tendering costs/delays etc.

This proposal is a significant departure from existing processes. We question how the ESO can be confident that consumer benefits can be derived from the delivery of projects, via early competition models, regardless of the value of the project in question. We look forward to seeing the Impact

² Ofgem, Guidance on the Criteria for Competition (23/01/2018)
https://www.ofgem.gov.uk/system/files/docs/2018/01/draft_criteria_guidance.pdf

Assessment exercise that the ESO has undertaken to justify this proposal that a no value threshold is in GB consumers' best interests.

The uncertainty as to which of a network operator's pipeline of future network projects will potentially be subject to delivery, via an early competition model, will undoubtedly affect investors' view of GB network operators as being stable, predictable regulated entities. This will in turn affect investor appetite to invest in GB network infrastructure, at a time when significant investment is needed to facilitate the UK, Scottish and Welsh Governments' Net Zero ambitions.

4. Do you agree with the approach where the ESO makes recommendations to Ofgem on the projects/needs which are suitable for competition?

Subject to the comments we make in our covering letter to this response, we agree that there could be a role for the ESO to play in identifying projects which meet the early competition criteria, similar to the role it currently plays in late competition, provided it is fully in line with the NOA process. We also agree that it is not for the ESO, as a fellow licensee, to determine what projects are suitable for delivery under early (or late) competition. That decision must be taken by Ofgem, following a robust CBA exercise, to ensure that additional consumer benefits can be derived. SPT is of the view that the only way this can be robustly measured is by using the TO's network proposal as the counterfactual solution against which all market bids are measured.

5. Do you agree that the incumbent TOs should participate in competitions through the same process as other bidders, and what mitigations may be needed to allow this?

We are fundamentally opposed to this proposal. If TOs participate as market players, we will be taken outside the realm of the regulatory framework in which we are designed to operate. This regulatory framework has been carefully designed over an extensive period of time to ensure energy security, affordability and carbon and greenhouse gas emission reductions are achieved.

Moving away from the existing framework (particularly with no value threshold) could result in an extremely complex and inefficient framework and suite of interfaces, with ambiguity in the responsibility and accountability for key issues such as long-term security of supply, asset integrity, robust health and safety measures and environmental management.

With the potential for early competition winners to be subject to different licence provisions, or no licence provisions at all, compared to those of the incumbent TOs for network operations, these proposals have the potential to dilute the strength of the licence obligations, under the 1989 Electricity Act, intended to ensure the effective development, maintenance and operation of a

resilient GB-wide transmission system, risking the operability and resilience of the network as a whole.

There is also a serious risk that the inclusion of a number of small players in the operation of the GB transmission network will add much greater complexity to the overall management of the transmission network, again risking the operability and resilience of the transmission network.

Furthermore, it is clear from earlier discussions with the ESO that 'ringfencing' arrangements are likely to be required, should the incumbent TO wish to participate in the market competition, to allow the incumbent TO to continue to perform its statutory responsibilities in terms of network planning and the technical assessment of connections. 'Ringfencing' arrangements will not only be complex for TOs to put in place but could impact our resources and abilities to execute these license responsibilities effectively.

We question the value of this arrangement to the consumer, particularly as the licensed monopoly network operator regulated framework was specifically designed to derive best value for consumers. We also question whether a business, that is regulated by existing licence obligations and duties (and specified rates of return governed by a price control), can fairly compete in an open market with market players, as is proposed in this consultation.

Given the stimulus to create a market that benefits the consumer from a price and innovation perspective, we also consider it critical that entrants have the same motivation and drivers that the incumbent TO has, with respect to the long-term development, maintenance and operation of the transmission network.

6. Which parties do you think would be best placed to fulfil each new role identified in the early competition model and why?

As mentioned in our covering letter above, in respect of the ESO, the ESO has neither the licensing powers nor does it have regulatory responsibility for early competition. Any such consultation on the proposed scope of the roles and responsibilities of parties involved in early competition models must be consistent with the ESO's licence and the existing regulatory regime. We do not believe this to be the case for this particular consultation exercise. We believe that it is the regulator's responsibility to be taking forward this consultation exercise, which considers the changing of the roles and responsibilities of licensees.

We note from this consultation document that the ESO's Phase 3 consultation will set out more detail on each of the new roles it has identified in early competition and will provide more information on the cost and implications of different options. We will provide further views on which parties we think would be best placed to fulfil each such new role once this information is made

available. However, in the meantime, we have shared our initial thoughts on some of the key roles proposed.

It is important that the licensed responsibilities of TOs to maintain an economic, efficient and coordinated transmission network is fully reflected in the roles and responsibilities to be set out in the forthcoming Phase 3 consultation. In advance of this, we welcome the ongoing engagement with the ESO in relation to the roles and responsibilities of TOs.

As part of the ESO's considerations of the roles and responsibilities, it is important that the conflicts of interest that may arise are properly explored now and as part of the Phase 3 consultation exercise, whether affecting market participants, the TOs or the ESO. We would also expect the Phase 3 consultation to set out how the ESO intends to demonstrate independence from potential conflicts of interest from other companies within the National Grid Group.

We believe that the procurement body or approver should have the same statutory duties as a TO with respect to its licence obligation of the "*development of an economic and efficient system*". The actions or inactions by the procurement body could have a significant impact on the safe, secure and economic operation of the wider system and adjacent systems. We would expect this to be reflected and regulated through appropriate governance procedures.

Furthermore, we would welcome more detail in the Phase 3 consultation process on whether the procurement body would be responsible for specifying technical standards and requirements. It is essential that the procurement body has the relevant expertise in place to ensure security of supply.

7. Do you agree with a TRS type revenue model as the default model? In what circumstances (if any) do you think a regulated model may be more appropriate?

We are strongly opposed to the proposal of a TRS model as the default solution for early competition. To ensure additional consumer benefit to the status quo arrangements, it is fundamental that the incumbent TO's proposed network solutions are treated as the 'counterfactual' against which market bids can be measured.

Given the lack of detail on the proposed TRS model itself, we are unable to comment on the proposal in detail. However, we would expect any revenue model to (i) provide cost certainty and protect against volatility and (ii) be clear enough at the tender stage for bidders to be transparent with costs and anticipated rates of return. We also query if the intention is to fix one revenue model as this would seem to restrict the benefits of competition.

Furthermore, if the incumbent TO is the winning bidder, delivery of the solution under a regulated delivery model is more appropriate as this would fit with the existing regulatory scrutiny performed

by Ofgem. This would reduce complexity and the costs incurred as a result. Which will ultimately drive best value for the consumer.

We note the reference to PPP as a relevant benchmark for early competition, and the suggestion that this has been a successful model to promote a TRS. We are surprised at this point in light of the UK Government's announcement in the October 2018 budget to abolish future PFI and PF2 (previously known as PPPs) contracts given the compelling evidence that these contracts neither deliver value for taxpayers nor genuinely transfer risk to the private sector. Furthermore, whilst there are other versions of PPP models in use in the UK (with Wales now using MIM and Scotland minded to do the same), bidders and lenders approach such models now with more caution, as a number of traditional PPPs are becoming increasingly contentious (whether due to alleged defects, maintenance, operation of their payment mechanisms and challenges public sector bodies are facing to make efficiencies in the face of a fixed payment profile). The reality is that PPP is not as simple as the availability of an asset, in return for a fixed payment. We consider that these risks remain in relation to the proposals for early competition and must be explored further.

8. Do you think that revenue during the preliminary works period would help encourage participation in early competition? If so, what mechanism would be most appropriate?

We believe, that as an incumbent TO, we are not best placed to answer this question. However, it is our view that some cashflow will be required prior to commissioning to ensure bidders can finance the proposed projects and maintain credit worthiness during the construction phase. Under the current TO delivery scenario, funding is provided as and when incurred, with further support provided financially through the wider regulatory framework and the associated revenues that entails. Therefore, in a situation where the incumbent TO is also the winning bidder, a lack of revenue prior to commissioning could in turn affect the incumbent TOs' credit ratings, and resultantly, their financeability licence conditions.

Furthermore, we note that the ESO considers the TRS model as applied in the OFTO sector as appropriate here. However, to date the OFTO-build model has not been utilised, so to date OFTO's have not taken construction risk and have not taken over the assets until they are commissioned. It is therefore not possible to do a direct read-across from typical OFTO bidders to this scenario without also taking some account of the difference in construction risk profile and the associated funding needed.

In the event that a revenue stream is considered during the preliminary works, we consider that payment milestones would need to be agreed. We would query whether these would be published ahead of any competition. Whatever the decision taken is, during the tendering process, to ensure a level playing field, all bidders would need to be aware of the extent of the proposed funding (noting this would be dependent on the successful bid) and the fact that it could potentially be subject to agreed payment milestones. Bidders may also expect a mechanism to accommodate unexpected

costs so that they can manage any potential risks, and costs associated, without putting their own solvency or delivery of the overall project at risk.

9. Do you agree with the current preferred option of setting the duration of the revenue period to the length of the network need?

We would agree from a business planning perspective that the duration of the revenue period should be set to the same length as the network need. As mentioned above, we do consider that some revenue will be required to ensure bidders can finance the proposed projects and maintain credit worthiness during the construction phase.

We would also welcome more detail on how the ESO envisages the length of network need will be evaluated and by which party, as well as further detail on the treatment of early asset write off where the network need has gone or has been superseded by a later reinforcement.

Any deviation from setting the duration of the revenue period to the length of the network need, should be identified and clarified at the initial evaluation stage, with an explanation weighted against the long-term security and function of the asset to be provided. We also question whether offering a shorter-term revenue period (i.e. 20-25 years as opposed to the network lifetime of 45 years) would attract parties who are not able to provide a safe and reliable service to consumers over the longer term, as per the current regulatory framework that TOs are designed to operate in. Furthermore, we do not believe that shorter term revenues will result in any customer benefit, when compared to the existing regulatory arrangements.

10. Do you agree that the maximum length of the revenue period should be capped? If so, at what length?

In principle, we believe that it makes sense to cap the maximum length of the revenue period to ensure that consumers are not paying for an asset that is no longer providing value to the system. However, such a scenario does cause issues in relation to how an asset is funded thereafter, especially if they have, for example, been recouped over a shorter period of time than its lifetime. Therefore, in this scenario there would be no revenue available, yet, the asset is still in use.

11. Do you agree with the current preferred option of including a mechanism for extending the revenue period? How should such a mechanism work?

We note the ESO's proposal to extend the revenue period where there continues to be a network need for the asset beyond the agreed contractual period. We would welcome further clarification on what arrangements the ESO would put in place to extend the revenue period and how the extension of a revenue period could be delivered in the most cost-effective way for consumers.

The ESO should also consider how this mechanism would be factored into the assessment of costs and benefits that a bid would represent. In what circumstances would such a mechanism be triggered? What would happen if the asset provider refinanced? How will the ESO cater for the situation whereby the asset condition can extend beyond its expected life expectancy? Consideration should also be given to whether the mechanism would seek to recalibrate the revenue in the earlier period and re-profile for the extension. We would expect these issues to be outlined in the Phase 3 consultation exercise.

We note the statement in the consultation document that the incumbent TO may be reluctant to adopt these assets. This appears to suggest that there is little confidence in the original asset provider in maintaining the asset to a standard capable of either transfer or future operation and value to the incumbent TO.

12. What is the most appropriate cost assessment mechanism for fixing underlying costs after preliminary works are completed?

We consider that market players are better placed to provide a more detailed response to this question. However, cost uncertainty after the tender may not always easily be managed. The timescales from bid to tender award to delivery can be very significant. Certain factors beyond the control of the bidder may create significant cost increases. This type of uncertainty needs to be addressed within the framework

13. Will there be enough lender interest in a debt competition to drive competitive pricing? What other debt structuring options do you think would be appropriate?

We consider that market players are better placed to provide a more detailed response to this question. However, we would have expected that detailed assessment of potential market players' solvency, credit rating, chase for capital risk and default positions on interest rates together with investigation into the investment potential of future market players, and resultantly how customers will be sheltered from any default, would have been carried out prior to this stage in the development of the ECP.

Furthermore, we believe that the ESO should use the existing regulatory safeguards in place for the incumbent TOs, as a minimum threshold evaluation, to ensure a level playing field and to ensure solvency risk, payback and other commercial interests are balanced against the long-term interests of the network.

***14. How should the indicative debt costs and level of gearing used in final bids be determined?
How should the risk of the actual amounts be allocated?***

We consider that market players are better placed to provide a more detailed response to this question.

SPT has no opinion on the mechanics of this process other than to note the outcomes that are required, namely (i) that robust financial assessment processes of market participants need to be put in place to minimise the risk of default and root out unrealistic/undeliverable bids (ii) that a Plan B solution is in place, in the event of default, (iii) to ensure that a cost-effective transmission asset is delivered to consumers, and (iv) to address the identified network need.

We also consider that the incumbent TOs, who have a regulated standard to adhere to with respect to debt financing (gearing and rates), credit rating, asset mortgaging for security will clearly be inhibited from being true market players if the assessment criteria for potential market participants as a qualifying or bid factor, is not consistent with those of the incumbent TOs.

15. Are there any other key risks that should be addressed at this stage?

We believe that prospective market entrants will detail what those risks could be. However, we suggest that the ESO seeks clarification as to how those risks identified should be managed in order to shield consumers from price fluctuations as well as the risk of stranded or sub-optimal assets and solvency issues. The ESO should also consider the extent to which there are any risks it proposes not managing, as well as whether any threshold for a reopener is likely to be priced into market bids, with those additional costs ultimately being passed to consumers.

***16. Do you consider the overall risk allocation between bidders and consumers appropriate?
What are your views on risk allocation?***

Standardising risk pre-determines the profile and allocation of costs. However, as some parties will undoubtedly be able to manage risk better than others, this will not lead to market optimisation. In a truly competitive market, it would be up to those organisations to determine what risks they, and the consumer, will bear. If the risk profile is pre-determined, on what basis does the assessment conclude on value for consumers?

Furthermore, we note that this proposal could be viewed as being weighted towards attracting market players rather than delivering best value for the consumer. For example, this allocation of risk may attract organisations who are inexperienced in the consultation process, standards and management of consents. This lack of experience and maturity could represent serious risk of

inefficiency, cost increases and delays to the delivery of the asset as the parties are effectively 'learning on the job'.

We would also note that in relation to Table 8, minimal risks are shown as being allocated to consumers. Whilst on the face of it, this might be the ESO's approach in its assessment of risks, it must be borne in mind that any risks passed to bidders, which have a financial impact, are likely to be passed to consumers through their electricity bills.

17. Do you have any views on the list of potential activities that could be undertaken to support bidders, the information that would be required and the potential value to consumers they could drive?

We believe that market players are better placed to respond to this question. However, we do question how offering additional support to bidders is in consumer's best interests.

It is our belief that any party who enters the process must be able to demonstrate that they are able to meet the requirements independently, at their own cost and risk (whether as a sole bid or as part of a consortium – which would then introduce interface and commercial risk).

Furthermore, the incumbent TOs are not funded to provide consultancy support to market players and will be bound by commercial confidentiality from our own suppliers in many aspects. Reliance on the incumbent TO to assist in the process implies that the TO from a capability, knowledge and skills perspective remain the most appropriate party to take forward asset development and construction. It is important that lessons are learned from the Pathfinder processes to date, whereby TOs have seen a significant increase in requests and queries from potential market bidders.

We would also add that pre-tender activities not only create additional costs for those facilitating the activities, but also require additional resource. If it is the ESO who is to fulfil this role, we would query (as we have above) whether the ESO has sufficient resource, expertise and capacity to do this.

18. What are your views on the challenge of flexing the procurement process to varying needs but maintaining standardisation?

In the first instance, we would question what benefits the ESO believes will be delivered by flexing the procurement process and whether they are confident this is in consumers' best interests.

The pre-qualification and advertising proposals are in line with standard processes and should be well understood by market players. However, there are no provisions or mention in the consultation document as to how the incumbent TO will be able to participate and how any competing requirements ordained under the price control framework will be addressed.

We therefore request further detail as to what this question is asking with respect to what are essentially competing statements.

19. Do you agree that the proposed list of primary information relating to network information is adequate to identify and cost potential solutions for both network and non-network solutions?

Firstly, we reiterate the point we made above, regarding information services that the incumbent TO could offer to potential market participants: the incumbent TOs are not funded or currently resourced to offer consultancy services to market players.

With regards to the proposed list of primary information set out in the consultation document, we believe this may be insufficient, and will primarily be driven by the nature of any particular project.

With regards to the choice of technology, an important aspect that has to be considered is the impact on, or interaction with, Users and existing or planned network equipment. To identify such impact or interactions, User data or equipment manufacturer data may be required. Where issues are identified, mitigation measures could have an impact on the project's cost. Although it is only likely to be an issue at the ITT (stage 2) point, it should still be considered as a risk for some projects.

Furthermore, the proposals in this part of the consultation document require clarity on the following:

- Noting also the Grid Code provisions amongst other things, whether an NDA is sufficient protection (and remedy for breach) for data exchange, for example, where a bidder's parent company/ affiliated companies holds generation or interconnector assets, and the ETYS models which could contain data about competitors.
- Given that for the incumbent TOs, business separation is required, and even then, only a data subset is available, whether the Boundary of Influence principle will be applied in such cases and if so, how it will be determined (see STC Schedule Three and Four).
- Some information, such as generator reactive power capability charts, is not routinely shared with TOs. Some User data in the ETYS is not easily protected by encryption. The ESO should provide further detail on whether important information, such as a generation ranking order, is expected to be shared.
- On page 66 of the consultation, it is suggested that the ESO expects to partially encrypt ETYS data. The ESO should clarify whether it is intended to tie the proposed ETYS data exchange format to a single network analysis software platform. If so, we would suggest the ESO considers whether this is acceptable in the context, as it may disadvantage some potential bidders.

20. What are your views on our current thinking for the elements that potential bidders should demonstrate at PQ?

We believe that the ESO's current thinking for the elements that potential bidders should demonstrate at PQ are in line with the standard criteria that would be expected. However, we believe that a rationale for the criteria, which should be led by ensuring consumer benefit, is missing.

Furthermore, we consider that demonstrable ethical practices and corporate social responsibility needs to be factored into this evaluation, together with specific details on any future licence obligations that may be required. Particularly regarding gearing, credit rating, debt financing, access to capital, availability of resource (including human capital) and independence from corporate group considerations.

Whilst we appreciate the ESO's reservations on creating barriers to entry for small market players and the threat to innovation, the ESO also needs to ensure that any intellectual property (IP) developed is secured for future use in the event of corporate default. We would expect that PQ must provide a statement from such market players that any IP created is legally able to be transferred, without restriction, in the event the need remains, but the provider is unable to continue to deliver.

21. Do you think that the range of criteria we are considering at ITT (stage 1) is appropriate and will drive value for consumers?

We believe the range of criteria is appropriate as they are the same standards and requirements that the incumbent TOs already undertake and adhere to.

22. Do you agree with our approach for evaluating bids at ITT (stage 2)?

We believe the approach is appropriate as it includes the same standards and requirements that the incumbent TOs already undertake and adhere to.

23. Do you agree with the criteria/features we have proposed to be within the evaluation?

We believe the criteria/features are appropriate as they are the same standards and requirements that the incumbent TOs already undertake and adhere to.

24. What are your views on our current thinking for the PB stage?

The proposed PB process will create further administration and needs to be clearer as to the preference or rationale for the awarding of a commercial contract/licence. Both processes will take time to bed in and for an understanding to be achieved, as to the standards that a party will be signing up to and will be required to adhere to. The present view lacks detail and as it states, is high

level, which does not allow for a proper analysis of any position proposed, assessment of the impact on the competition and assurance of a stable and fair regulatory regime.

We also note that a detailed mapping exercise is expected to be undertaken by the ESO over Summer 2020 with further detail being consulted upon in the Phase 3 consultation. We will provide more detail on our views of the ESO's thinking for the PB stage once this exercise has been completed and shared with us. This will provide more detail to allow us to undertake a proper analysis of what is being proposed for the PB stage.

25. What is your view on the need for a bid bond and what do you think would be an appropriate value and time period?

We consider that market players are better placed to provide a more detailed response to this question. However, it would seem appropriate for this decision to be based on the risks and benefits that a bid bond would cover. We also consider that (i) the costs of providing such a bond should be calculated in any financial assessment of a bid and (ii) query the need to introduce this type of arrangement, given it is not currently needed. It almost appears to suggest that there is doubt with respect to the financial strength or covenant of future market players to meet their obligations unilaterally or worse, their long-term commitment to the provision of an asset/service cannot be determined robustly.

The ESO should also factor in the fact that any bid bond will attract a financing premium and we would query the merits of such costs ultimately being passed to the consumer.

26. Do you agree the tender revenue stream should not commence until successful commissioning and that no payments should be made to the successful bidder prior to this point, except potentially for preliminary works and/or where there is a particularly long solution delivery works programme?

As in our response to question 8 it is our view that some cashflow will be required prior to commissioning to ensure bidders can finance the proposed projects and maintain credit worthiness during the construction phase. This will be more so in the case of large projects, and mega-projects (as referred to in the consultation) than smaller projects. Under the current TO delivery scenario, funding is provided, as and when incurred, with further support provided financially through the wider regulatory framework and the associated revenues that entails. Therefore, in a situation where the incumbent TO is also the winning bidder, a lack of revenue prior to commissioning could in turn affect the incumbent TOs credit ratings and, resultantly, their financeability licence conditions.

Furthermore, we also question how restricting cashflow will attract development phase investment. The eligibility criteria will need to address this otherwise (i) the market will not respond and (ii) projects in delay become victim to commercial pressures and costs will be passed through to

consumers. Whilst this may be viewed as an imperative to attract market interest, we question how these proposals measure against the regulated TO position, which is already enshrined in licence, with respect to outputs under the RIIO model. This would seem to suggest that the TO may form part of a market bid but cannot benefit from early revenues (if that is the model) that securing the competition would yield.

27. Do you have any views on incentives or penalties in relation to preliminary works and solution delivery, including the impact of commissioning delays on the tender revenue stream / revenue period?

It is our view that the winning bidder should be held to the same standards that the incumbent TOs are, for example in terms of environmental and technical standards, as they will be connected to the incumbent TOs' networks. The incumbent TO will still carry a level of return on regulatory equity (RORE) risk in these areas, and so it is important that the performance of the winning bidder does not adversely affect the incumbent TOs' performance in these areas.

However, the ESO will need to be mindful of the legalities around "penalties" with market participants. Furthermore, if the successful bidder is only to be paid TRS from the commissioning date, the incentive on the bidder will be payment of the TRS – anything more than this could act as a "double-hit" with potential "penalties" for late delivery and non-payment of the TRS. Any bidder would not be able to pass such a double-hit of "penalties" to contractors.

Furthermore, the winning bidder should be required to comply with the STC and be expected to develop and offer connections to their assets in accordance with the industry codes and practice to ensure customer (Load and Demand) interests are protected. Primary outputs should be based on availability and timely delivery, with secondary incentives on asset condition also being required to ensure adequate asset management processes and procedures are in place.

With regards to preliminary works and solution delivery stakeholder engagement, we also believe that there is a risk of creating a strong incentive for a successful bidder to maximise profit by getting their single scope of works built, without due regard for the wider position or ongoing development of the transmission system within the communities which it serves.

TOs have invested significantly in understanding community issues and taking steps to resolve them. For example, through landscaping or reducing impacts through related construction work. In addition, a critical activity required to deliver Transmission projects is gaining land access to enable construction work on any approved route. SPT has published a Grantor's Charter that explicitly assures land owners of the standards SPT will adhere to. If a winning bidder is unable to achieve the same level of community trust and engagement, significant unexpected additional delays may be incurred. The ESO or winning bidder will need to achieve a similar level of community trust and engagement.

28. Do you agree that the existing industry arrangements in respect of commissioning will be appropriate for early competition with minor adaptations? What adaptations do you think would be required?

Historically, the commissioning of complex assets has carried a significant risk to the network and customers (both load and demand). The current arrangements for the provision of commissioning data in advance and the process of physical commissioning agreed through the TSO and TOs, has been developed over many years to ensure best practice and lesson learned. On this basis the current STC / STCP arrangements should be maintained and any bespoke or project specific adaptations necessary should only be agreed and implemented following the agreement of all relevant stakeholders i.e. the ESO, TO, commissioning party and any other appropriate major stakeholders.

29. Do you agree with the proposed potential operational incentive regime for early competition? Are there any topics omitted which you feel should be incentivised and why?

We note that it is the intention of the ESO to model Early Competition on the current model used for OFTOs but are intending to incentivise the winning party based on the RIIO model. Given the significant differences between these models, we would ask for further details from the ESO on how they plan to merge these models together.

We also question whether it is in consumers' best interest to financially incentivise a party to deliver what they are obliged, by contract, to deliver. It is therefore our view that the operational incentive regime for early competition should be limited.

30. Do you agree that with minor adaptations the existing industry codes/processes they can incorporate both network solutions and non-network solutions arising from early competition? Are there any fundamental gaps or issues you foresee in relation to early competition?

We would welcome the ESO clarifying what they classify as 'minor' adaptations. We require further details on what industry codes would require to be updated and how this process would be governed.

Whilst the existing codes and processes can be modified to incorporate solutions, we do not agree that they will necessarily be 'minor' adaptations or as straight forward as first thought, especially if a more integrated solution is adopted. It is likely that a number of Grid Code definitions will need to be altered. For example, Large Power Station, this is currently defined in terms of NGET's Transmission System, SPT's Transmission System, SHETL's Transmission System and the Offshore Transmission System and varies (as amongst these four defined terms) depending on the Registered Capacity.

It would also be essential to understand whether a CATO would be treated in a similar way to an OFTO or as an existing onshore TO, or a hybrid of both. Whilst the regulatory treatment may be similar to an OFTO, these parties are likely to behave more like an onshore TO. As such we don't believe that the existing OFTO provisions can be easily transferred to this new entity; offshore connections tend to be more radial and have a defined connection point to the National Electricity Transmission System (NETS), whereas, under the early competition framework, connections may form part of the NETS. As market winners won't necessarily be a full onshore TO, then some "Relevant Transmission Licensee" (as defined and detailed in the Grid Code) requirements may not be able to apply and as such it may be necessary to find a way of accommodating this hybrid arrangement.

Whilst an OFTO generally doesn't influence the operation of the onshore network, it is anticipated that an early competition market winner, which will be integrated into the existing NETS, will have an influence on the NETS, and as such they will need to be included within the relevant Grid Codes covering aspects such as safety coordination and connections. This may need some consideration of the terms and definitions used to avoid any inadvertent consequences.

If new parties will be subject to existing codes, such as the Grid Code, then they will need to be formally included within the governance arrangements of such codes. This could potentially take some time and, the extent to which they are formally included may need to vary depending on whether it is a network or non-network solution and should be built into the ESO's development timelines.

The ESO will be aware that the present interactions between the ESO and TOs are properly governed by the STC. Under this arrangement there are established entry points and governance for changes to be made to this arrangement. Whilst the STC panel members will form a future stakeholder group for any industry changes that materialise, we consider that the role the ESO is undertaking here has the potential to dilute and impair this forum as well as its ability to progress change. This forum has been established under a convention of equal partnership and the adoption of a regulatory proposition, of this significance, risks undermining this.

31. Do you agree that decommissioning costs should be considered as part of the tender evaluation and that there should be an obligation on the successful bidder to develop a proportionate decommissioning plan and place a form of decommissioning security at an appropriate time?

We fail to see why decommissioning costs, which form part of a project life cycle, would not form a requirement of any bid. We don't believe that a bid can be successful simply on the submission of a lower cost bid that does not (i) forecast and include the cost of decommissioning; (ii) provide a plan for the decommissioning and (iii) a form of security for the costs associated with these works. We would also consider that any planning consent would be conditional upon an agreed plan for the

removal of redundant assets and environmental reinstatement. Furthermore, with respect to impacts on local communities and stakeholders, it is critical that these matters are identified and planned for, when engaging in a relationship with those communities.

SP House, 320 St Vincent Street, Glasgow. G2 5AD

Telephone: 0141 614 5213

www.spenergynetworks.co.uk

SP Transmission plc, Registered Office: Ochil House, Technology Avenue, Blantyre, G72 0HT Registered in Scotland No. 189126 Vat No. GB 659 3720 08
SP Manweb plc, Registered Office: 3 Prenton Way, Prenton, CH43 3ET Registered in England and Wales No. 2366937 Vat No. GB659 3720 08
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