

National Grid Ventures: Early Competition Plan, Phase 2 Consultation

February 2021

National Grid Ventures (NGV) is the competitive division of National Grid plc. We are ring-fenced from the core regulated businesses in the UK and US and are responsible for developing new opportunities in line with our core business capabilities. Our diverse portfolio of low carbon and renewable energy businesses includes sub-sea HVDC interconnectors and liquified natural gas in the UK and Europe, as well as battery storage, wind and solar power in the US.

NGV has a record of developing innovative and ambitious transmission solutions: the Nemo Link interconnector was the first to transmit 400 kV voltage with XLPE DC cable; once operational NSL will be the world's longest subsea interconnector; and the Viking Link interconnector will pass through four different national jurisdictions as well as four UK local planning authorities. We are responding to this consultation as an experienced developer and operator, with expertise in interfacing with complex European transmission networks, managing multiple and varied permitting requirements, and operating within different regulatory frameworks. As competition is introduced, we are keen to participate in tendering for onshore and offshore projects that would benefit from our capabilities, in particular, we would expect relatively larger network projects, where we can help to facilitate the development of the most efficient and effective solutions, to be well suited to our business.

As we reflected in our previous response, any potential to introduce innovation and cost savings to consumers must be explored, however it is extremely important to design an effective process that will deliver the potential for consumer cost savings. It is important that bidders are able to balance the levels of risk and reward throughout the life cycle of their bid. If at any stage the risks and rewards become imbalanced this will lead to sub-optimal outcomes for the overall process as bidders either price in risk that has become unavoidable or simply do not participate.

We also believe that it is critical that there is a clear pipeline of projects for bidders to target. The costs of a bid and the maintenance of a team of skilled experts able to deliver future bids will not be a small overhead. It is crucial then that the pipeline is visible in order that these fixed costs of participation can be justified.

We have answered the consultation questions by exception, that is, we will only respond where we have specific feedback or concerns to highlight on the proposals.

We are happy for our response to be published (not anonymised) and are happy to be contacted by the ESO about any details contained in the response.

Chapter 2 – Roles and responsibilities

Do you agree with our proposed approach to conflict mitigation?

We note the recommendation from NG ESO that TOs continue to play their current role with respect to network planning, but with additional mechanisms to minimise actual or perceived conflicts.

This would see both a strengthened ESO capability to challenge and review TOs proposals, further consultation with industry and ring-fenced bidding teams within TOs should the TO that has identified the network need subsequently bid in the Early Competition Process.

We would note that the suggested approach to use ring-fencing is similar to that where National Grid Ventures is ring-fenced from the main National Grid business and which has led to significant delivery of benefits to consumers via our programme of interconnector investment.

Chapter 3 – Identifying Projects

Do you agree that only competing projects that appear in at least 2 FES scenarios will provide sufficient confidence that the project will go ahead?

The identification of individual projects and the subsequent pipeline of work that this represents will be key to the success of early competition. Without a robust pipeline of work it may simply be infeasible for sufficient bidders to maintain the skills and expertise within their organisations to deliver high quality competitive bids into the process.

A linkage to the FES process appears sensible in terms of identifying a robust need for a specific project and the ESO has proposed that a minimum of 2+ FES scenarios should be the minimum for a project to be eligible for the Early Competition process. We are particularly interested in the impacts of a project that having entered the process, subsequently falls outside of the criteria, perhaps dropping down into 1 or zero FES scenarios and the likelihood of this occurring. If a project were to drop into less than 2 FES scenarios after previously being in the Early Competition Process, would that project be suspended or cancelled at that point? If so then we would presume that the mechanism for the refund of efficiently committed and or incurred costs would apply. Given that bidders might wish to prioritise efforts on Bids that are most likely not to be cancelled it may be that each project needs an indication from the ESO of its certainty of continuing to be in multiple FES scenarios.

Chapter 4 – commercial model

Do you agree with our revised views and preferences in respect of the PPWCA, Performance Bond and IAEs? Why?

Caps/Collars on TRS

We note that the proposed design of the commercial model means that the cost of equity is fixed at bid stage. As a general principle we do not have an objection to this but with a caveat. There must then be full flexibility in risk provision (termed 'cost margins' by ESO) so that risk allocation at PPWCA is equal to that at bid. The cost of equity is completely linked to the risk profile of the project and so adjustments may need to be made if, during the PPWCA stage, the risk profile of the project changes materially.

We do not agree with the proposed cap and collar treatment for the Total Revenue Stream. All costs will be subject to an 'efficient and economic' test and so it seems arbitrary and punitive to disallow otherwise economic and efficient costs simply because they have risen above a cap. In extreme cases where a cap is hit, a bidder may lose all of its return simply because a cap is in place, despite acting economically and efficiently throughout. HVDC cable costs (which are highly correlated to market conditions) is a good example of where costs can vary significantly over time.

Similarly, the collar doesn't necessarily work in the interests of consumers. Again, if acting economically and efficiently costs fall below the collar then the developer will effectively receive windfall gains at the expense of the consumer.

If it is deemed a crucial design feature to retain caps and collars, we would suggest that a Bidder have the right to exit the project without penalty should the cap be reached.

Performance Bond

We do not agree with the proposals for the performance bond. We disagree on both the timing of the bond and the proposed level at which it is set.

The timing of the Bond from Bidder selection we feel is far too early in the process. There are significant risks that are largely beyond the control of the bidder which could lead to the failure of the project, most notably the planning process. It is unfair that a performance bond be forfeit for such risks outside the control of the Bidder. We would suggest then that the performance bond only apply from the onset of construction activities, and potentially that its level is slowly reduced over the course of that construction activity.

We also feel that the level of 20% is too high. Some of these projects are billion-pound projects leading to hundreds of millions of potential securities being required. The ability to source such securities from the market, especially if these may be forfeit for risks such as planning refusals may mean that there is little appetite from banks to provide them other than at extremely high costs.

Risk allocation table

The risk allocation table suggests that connection delays would be at the risk of the bidder, but this appears to be outside of the bidder's control, (GB grid connection agreements have target dates, but rarely include damages for delay) so we would argue should not be included.

Do you agree with our preferred option regarding margins and overheads? Why?

The proposals assume that project management costs can be fixed at ITT, however it should be noted that the final size and nature of the project management team will depend on the structure, terms and counterparty for the construction contract(s). To avoid large initial risk-provisions related to project management costs, it may well be more efficient to allow this cost to be adjusted subject to the 'efficient and economic' test.

Are there any additional measures a Procurement Body could take to further drive value for consumers in securing debt finance?

Debt competition

We note a further risk for equity funders connected with the proposals for a debt competition. Under the proposed process, equity cannot benefit from efficient gearing (above that assumed at ITT) but equity will face the risks from gearing above that assumed at ITT. For example, if gearing moves from 50% at ITT to 70% at PPWCA the risk to equity must have

increased as there are now large fixed debt repayments which in turn makes the equity returns more volatile.

The corresponding risk is also present for consumers if gearing assumptions made by Bidders turn out to be conservative which may give a bidder a potential excess return.

We think a better overall approach might be to allow for a further adjustment to bids should the debt competition deliver a level of gearing significantly different to that assumed by the Bidders. This would give a level of protection to both the consumer and Bidders and should make the overall process more efficient and effective.

Increased costs of debt following debt competition

There is also a need to consider to what extent external debt providers will want to dictate the terms of the construction and operating contracts. They are likely to want a relatively risk-free vehicle to lend to. This in turn will increase construction costs and TRS but will not be known at the ITT stage. These additional costs should be seen as permissible (economic and efficient) if being imposed by a debt competition, and if caps are to be applied to TRS then they should be increased in line with these increased costs.

Chapter 5 – End to End Process

Do you agree with our preferred position on Invitation to Tender stage 1 assessment and process? Please explain your answer.

Tender Process Structure

We have some concerns with the proposed structure of the tender process. Our principal concern is that the absence of quantitative (cost or otherwise) or qualitative differentiation between bidders at Stage 1 means that a large number of bidders may progress to Stage 2. Under the current process, Bidders will be required to commit to an extensive and costly Stage 2 bid process with no insight about whether they are likely to be competitive against other Bidders, which ultimately may result in lack of bidder interest at the outset. This is of particularly pertinent given that by design, Early Competition will see network and non-network solutions in competition.

We would suggest that the Stage 1 of the bidding process does have some form of quantitative and/or qualitative assessment beyond the simple “pass / fail” assessment currently proposed. In addition, we would suggest that the ESO also considers, in aggregate: a published limit to the number of bidders proceeding to Stage 2; and/or the underwriting of bidding costs at Stage 2, such costs to be proposed in each Bidder’s Stage 1 proposal. In our view, a suitable permutation of these suggested approaches will result in a process that strikes a balance between competition, bidder confidence, and bidder commitment to the tender process.

Chapter 6 – implementation plan

Do you agree with our proposed timing and sequencing for implementation plan activities? If not, what would you change?

Overall we would agree that the timing and sequencing looks sensible. The critical path activities will need to be established. For example which of the code changes would need to be approved prior to creating and issuing tender documentation, etc. We note that the intent is for substantive work to begin only once legislation is in place. The form of legislation could also be helpful in efficient achievement of the overall plan. For example, legislation

can grant powers to the Secretary of State to amend codes and licences in connection with major projects and such powers were taken to implement the New Electricity Trading Arrangements (NETA) and British Electricity Transmission and Trading Arrangements (BETTA) in the early part of this century.

Such a process could help establish the code and licence changes in a more expeditious manner than through normal industry change governance processes. These processes were not necessarily set up with far reaching reform of critical processes in mind, rather incremental changes.

By way of an example, the implementation of the Transmission Charging Review has led to a large number of CUSC amendments each of which has drawn significant industry resource and in an effort to allow a variety of approaches to be considered by Ofgem has resulted in a very large number of Alternative Amendments being proposed (the recent CUSC Amendment CMP 317/327 had a total of 83 Alternative Amendments presented to Ofgem). Where Government / Ofgem has consulted on options for code changes under primary legislative powers, a refinement of the preferred options can be undertaken without having to fully develop every single permutation which should lead to greater efficiency for these types of large-scale change projects.

Do you agree with the 'potentially advanceable' implementation plan activities? If not, what would you change?

The highlighted work (Future Energy Scenarios, ETYS, NOA, Early Competition Criteria Methodology, and the building of capability and capacity in the new roles -e.g. procurement body) could indeed be advanced prior to a final decision on the exact form of early competition being taken by Ofgem. Of course the costs of this new process and where funding for them ultimately rests will be determined as part of its implementation, including any stranded costs associated with early implementation projects that have to be reworked or even abandoned, so this should be undertaken with caution.

Do you agree with our views on early competition prior to early competition legislation? Why?

We agree with the approach being suggested. It would seem sensible to reappraise what can be achieved once the early competition proposals are finalised, and again once legislation is in place.