Early Competition

Low Regret Activities summary

December 2021

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Contents

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Executive Summary

Early competition has the potential to deliver significant value to consumers. The ESO has therefore welcomed the opportunity to continue to develop early competition thinking, following the publication of our Early Competition Plan (ECP) in April this year. We look forward to Ofgem's decision early in 2022 on whether they wish to implement early competition. Should Ofgem wish to implement, we believe our 'low regrets' activity has put in us a good place to move forward to implement early competition as quickly as possible.

During this phase we have identified internal processes that are required to identify projects for competition through the Network Options Assessment (NOA) process and for connections enabling works, and we have reflected on the criteria for competition. We have also considered how asset replacement projects could be identified for competition. Furthermore, we have developed a cost benefit analysis (CBA) to identify projects that are likely to achieve consumer value if competed.

It should be noted that there is an ongoing review of network planning process, with a potential move to a more strategic planning approach. Our low regrets work has focused on existing processes and would need to be reviewed once the new processes are clearer. Overall, we expect strategic planning to be helpful for early competition.

Another area we have progressed, beyond Ofgem's original request in May, is to identify how network models could be made available to competition participants in a legally compliant manner while protecting sensitive data. We believe the risks associated with making appropriate network models available can be suitably mitigated. Ideally, this will include measures that bring all bidders into the same legal and regulatory framework, setting out obligations on data control and sanctions for disclosure.

In addition, we have identified the areas of industry codes that will need to be modified in order to support the introduction of our proposed early competition model. To allow us to raise these modifications, primary legislation is required to create the concept of a transmission licence being awarded to the winner of a network competition and confirmation of how that licence differs from an incumbent TO.

We have further developed our implementation plan for early competition so that this can be put into action as soon as Ofgem make a decision on whether to proceed. Having reflected on the implementation plan, we are now of the view that the earliest point to launch a tender would be Autumn 2024 (six months later than originally anticipated). This is due to challenges in launching pre-tender activity prior to BEIS confirming the Appointed Body and interactions with decisions on the Future System Operator.

Alongside this implementation planning, we are undertaking work to design an operating model for the procurement body as well as contract counterparty and payment counterparty roles that will be required for early competition. This work will report in January (as agreed with Ofgem). It will also feed in to our RIIO2 Business Planning 2 activity.

Given that early competition cannot launch until legislation is in place, Ofgem has asked the ESO to explore whether we can make progress with implementing the model through existing competitive routes before legislation is in place – i.e. the NOA Pathfinders. We have identified a number of elements of the early competition model that could be applied to our Pathfinders. Indeed, we have been able to go a step further and actually implement aspects of the model into the recently launched Stability 3 Pathfinder. We are working to be ready to introduce more aspects of the early competition model as opportunities arise in 2022 and early 2023, ahead of legislation that is expected to be in place mid-2023. This will assist with the development of the early competition model and again help progress full implementation as quickly as possible.

We have also worked with Distribution Network Owner stakeholders to create a picture of what modifications might be needed to transpose the proposed early competition model for utilisation at a distribution level. The primary changes identified are around the project identification process and the criteria for competition, as different planning processes are in place at distribution level and the nature of investments decisions differ. Beyond that, the early competition model as it stands appears broadly transferable.

Overall, we believe we are in a good position to begin implementation of early competition, ready for a tender launch date in Autumn 2024.

Summary of low regrets deliverables

Project identification

Network planning processes are currently being reviewed, with changes expected to the NOA (Network Options Assessment) process in future. This document is written on the basis of NOA processes and will need to be reviewed once new network planning processes are developed. The new network planning processes for strategic projects may provide greater clarity of requirements further ahead of need than the current planning processes, which will be helpful for early competition.

We continue to believe that new and separable are important, and interrelated, criteria. New and separable should consider whether separable alternatives are technically and commercially viable. We should aim to compete projects once they have appeared in two FES scenarios, in two successive NOAs. If there are rare occasions where timeframes don't allow this, a case-by-case decision should be made. We have developed a draft Cost Benefit Assessment (CBA) methodology and model (subject to stakeholder consultation) to calculate which projects are likely to deliver consumer value if competed.

We have mapped the internal process steps we will follow to identify projects stemming from the NOA process so that we are able to quickly implement this should Ofgem decide to proceed with competition. We have also extended our Interested Person's Options process timeframes to better enable third parties to influence the initial planning process and thereby potentially influence the shape of tenders. Further details on this are available in the NOA methodology[1].

We have also identified the internal process steps we would take to identify connection enabling works for competition and have explored how asset replacement projects would be identified. We do not envisage many projects will emerge through either route. Additional information (connections) and action (asset replacement) will be required from TOs to administer the identification of these projects.

In addition, we have also considered the interactions with uncertainty mechanisms. Generally, early competitions would be triggered before uncertainty mechanism processes take place. However, on occasion, a project could have commenced before being competed, in which case any costs already foregone may need to be factored into the decision to compete.

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[1] https://www.nationalgrideso.com/research-publications/network-options-assessment-noa/methodology

Model access

In the ECP we outlined potential ways to facilitate bidders accessing the network models required to design their solutions. We have further developed our thinking on this. Our preferred option is to provide access to a bespoke model designed for each early competition. We don't believe that bidders require access to the full models used for network planning, which contain more operationally and commercially sensitive data. The bespoke model will, however, still contain potential sensitive and/or confidential information. We believe the challenges that arise from this can be mitigated through:

- An ESO licence condition to provide information appropriate to support the competitive process
- Bidders required to pre-qualify and to sign a non-disclosure agreement (NDA)
- Access to a model via a data room with controlled access to nominated users
- Ensuring that all bidders are subject to the current, or a comparable, legal and regulatory framework governing sharing of data.

Pre-legislative competition

The full early competition process cannot begin until after legislation has been passed to enable Ofgem to trigger competitions. Therefore, we have explored what could be done in the meantime through existing competitive routes to begin to develop the full early competition model. This means looking at where our NOA Pathfinders could adopt elements of the early competition model proposals. Our preferred future state is that NOA Pathfinders and early competition are aligned into a single flexible Network Competition framework.

We have gone beyond our original plan of identifying opportunities and have been able to adopt a number of 'quick wins' in our Stability 3 Pathfinder[2]. This includes an approach to technical evaluation, a commercial adjustment factor, the use of a procurement portal to run the event and an expanded approach to pre-qualification. We are also working closely with our NOA Pathfinder teams to resolve common challenges that impact both competitive routes, such as licence type, clarifying SQSS[3] compliance accountability and TO participation on a similar commercial basis to market bidders.

We also conducted an initial exploration of whether fundamental differences between Pathfinder and early competition could be trialled via Pathfinders in 2022/early 2023. We considered both multi TO participation and whether new types of needs could trialled but have concluded that these should not be progressed on the basis that either legislation is required, or the time and effort to implement without legislation is likely to be equal to the legislative timescales, therefore not delivering value.

Code change scoping

We have reviewed all network codes to identify what changes will be required in order to introduce early competition. This included considering changes for a solution with a transmission licence (a 'network' solution) and also considering any changes required if the winning solution is not eligible

[2] https://www.nationalgrideso.com/future-energy/projects/pathfinders/stability
[3] https://www.nationalgrideso.com/industry-information/codes/security-and-quality-supply-standards

for a transmission licence (a 'non-network' solution). We do not foresee any major blockers to making these code changes, beyond industry capacity to administer the changes.

We had assumed that legislation would establish the concept of a Competitively Appointed Transmission Owner (CATO) and as such, we refer to CATOs in our report. If this is not the case, we will need to revisit these code changes, dependent on the clarity Ofgem can provide on how similar new TOs created through competition will be to incumbent TO.

Broadly, we expect code requirements for CATOs to be similar to those for existing TOs. The concept of a CATO, and references to them, would need to be inserted throughout all codes where appropriate.

Reference will also need to be introduced in the STC[4] to the differing commercial model for competed projects to RIIO funded projects. In addition, we recommend clarifying interface interactions between different parties. While interfaces already exist between TOs, they are not clearly defined under the STC.

The Grid Code[5] will require changes to safety and technical standards to include CATOs and to the definition of small, medium and large power station threshold within the context of CATO.

Within CUSC[6] the charging section will need to be updated to clarify how BSUoS (Balancing Services Use of System) and TNUoS (Transmission Network Use of System) charges will be used to recover the costs of network competition, depending on whether the solution is a network solution or non-network solution. Further modifications may also be required to ensure the user connection process and pre-connection securities methodologies are appropriate for non-network solutions (dependent on Ofgem licencing/ regulatory review).

Implications for the SQSS are limited to a small update required to definitions of small, medium and large power station thresholds. No BSC[7] change requirements have been identified to date. This will be reviewed during implementation.

Changes required for competition at Distribution Level

We have worked closely with the ENA (Energy Networks Association) to consider the applicability of the transmission level early competition model to competitions at the distribution level. The level of potential modification identified overall appears relatively low at this stage. Two areas have been identified as potentially requiring some modifications to reflect different drivers in distribution. These are criteria for competition and the project identification process. Expected changes to codes, licence and legislation will need to be of an equivalent nature for distribution as those required at transmission level.

Implementation planning

We have further developed the implementation plan that we set out in the ECP, including a further breakdown of activities. Having reflected on the implementation plan, we are now of the view that the earliest point to launch a tender would be Autumn 2024 (six months later than originally

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[4] https://www.nationalgrideso.com/industry-information/codes/system-operator-transmission-owner-code-stc
[5] https://www.nationalgrideso.com/industry-information/codes/grid-code
[6] https://www.nationalgrideso.com/industry-information/codes/connection-and-use-system-code-cusc
[7] https://www.nationalgrideso.com/industry-information/codes/balancing-settlement-code-bsc

anticipated). This is due to challenges in launching pre-tender activity prior to BEIS confirming the Appointed Body and interactions with decisions on the Future System Operator.

In order to meet this tender launch date we need to keep progressing and not lose momentum. We have already begun planning for implementation and have identified the resource we will require for this. We continue to believe that implementation will incur further costs of around £6m. To meet our timeframes, we need to have most of the full team in place in early Quarter 1 2022/23. This means we need to begin our team building processes during January. Therefore, the initial stages of this may need to commence ahead of a decision from Ofgem on whether to implement early competition.

Organisational design

We have set out what the key roles for early competition that might be undertaken by the ESO should look like. The roles are the procurement body (referred to as Appointed Body in BEIS's consultation[8]), contract counterparty and payment counterparty. This covers resourcing capacity and capabilities, technology requirements, governance and interfaces with other early competition roles. This information has informed our Business Planning[9], and Future System Operator[10], planning processes. Further planning will be required during the implementation phase.

Next steps

If Ofgem decide to progress early competition we will begin implementation early next year.

[8] https://www.gov.uk/government/consultations/competition-in-onshore-electricity-networks
[9] https://www.nationalgrideso.com/our-strategy/riio/get-involved
[10] https://www.gov.uk/government/consultations/proposals-for-a-future-system-operator-role