National Grid Ventures:
Early Competition Plan, Phase 2 Consultation

August 2020

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.

Any potential to introduce innovation and cost savings to consumers is important, however deliverability and availability must be the fundamental considerations in determining the most appropriate competitive model and solution to a network need. As such we were pleased to see that the assessment framework for tenders (Section 5.5) included a comprehensive list of aspects contributing towards the evaluation of technical and project delivery. In addition to this, we agree with that a strong availability incentive, once the project enters operation, is fundamental to the success of any model solution.

Between the CATO models, we consider that the early approach introduces the most opportunity for competitive benefits from innovation and supply chain involvement in shaping the solution to minimise costs. However, it is critical that the apportionment of risk between the developer and the consumer is right, in particular, if the developer is expected to take on a higher burden of development risk than they would face in other comparable projects, this will be result in higher pricing and/or fewer bidders. Typically, a developer retains the option to exit the project or change the proposed solution over the preliminary works stage. This reflects the high level of uncertainty and risk that exists around the processes of obtaining consents and land rights. Whilst the final allowed costs are fixed after the preliminary works have been completed, the tender model arrangements should explicitly confirm how the assessment of final preliminary costs and risk will be undertaken to ensure the developer has clear visibility of the scope of risk they are assuming.

Finally, it is critical that the enduring solution has a robust framework in place to manage the delineation of accountabilities between the ESO, the incumbent TO, the CATO and Ofgem, in cases of failing to deliver, delays and/or availability problems. We agree that amending the industry codes would be an appropriate mechanism for setting out these arrangements.

We will answer the consultation questions by exception, that is, we will only respond where we have specific feedback or concerns to highlight on the proposals. Where we do not respond to a question the ESO may assume that we broadly agree with the preferred proposals set out in the document.

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.

Consultation Question Responses

1.1 Identifying network needs

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

Subject to the proposed criteria for competition being met, in particular, that projects should be new and separable, we largely agree with the suggested drivers of network need. However, connections wider works are within the scope of the late CATO process, likewise they should be within scope of consideration for early competition. This should not be dependent on their inclusion in the NOA and ETYS process.

1.3 Criteria for competition

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

We agree with the criteria proposed in the consultation for competition and in the case of dedicated new connections we would add customer appetite as an additional consideration. Potentially this would feed into 'certainty of need' but it is important that this external stakeholder view representing their plans and priorities feeds into the assessment in addition to outputs from the ESO's existing processes (e.g. the FES scenarios).

1.4 Tender decision

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

We agree with the proposed approach that the ESO uses a transparent decision-making process to assess the suitability of a project for competition and then makes a recommendation to Ofgem.

As part of this, it is important that relevant stakeholders can input into the assessment process. As mentioned in the report, the market's appetite to tender the project is a key consideration. In addition, provided it is given objectively, the view of the incumbent TO on suitability should also transparently feed into the process, particularly on questions such as the separability and operability of the assets.

Noting the discussion in the consultation paper on the potential use of an independent panel of experts to support the ESO's recommendation process, we agree with some of the stakeholder views that this is unlikely to help process transparency and that the ESO should be able to come to an informed conclusion independently. In the case of proposals that would introduce a new technology or software, where the ESO may not have sufficient 'in-house' technical expertise, the ESO may choose to contract specialist experts/consultants to support the decision making, however there are transparency benefits to concentrating decision making accountability between fewer bodies (i.e. the procurement body and the approver).

3.1 Revenue

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?*

It is likely that revenue payments during preliminary works (and during construction, in the event of lengthy construction periods) would encourage wider early competition by enabling bidders with limited financial resources to participate. If a mechanism is introduced to facilitate this, it is critical that it is designed in such a way that the incentive for timely delivery of the project's substantial completion is not diminished.

In addition, guaranteeing that the successful bidder will be entitled to full compensation in the event that a needs case is withdrawn is fundamental to encouraging participation in early competition.

3.2 Revenue period

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

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

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 agree that the appropriate payment structure for CATO is a Tender Revenue Stream (TRS) paid over the expected duration of network need, capped to a maximum period length. The ESO's suggested maximum revenue period length of 45 years is a long period over which to repay equity and debt when considered against comparable projects (such as OFTOs or interconnectors). Such a long revenue period may result in reduced market appetite to participate in competition and/or significant premiums built into bids to cover uncertainty associated with the long time horizon. We agree that a mechanism should be included to extend the duration of revenue period with the asset owner. Renewing agreements at the end of 20 or 25 years need not be overly complex, there is a precedent for this with the IFA 2000 interconnector asset.

3.3 Costs

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

Given the considerable uncertainty associated with the preliminary works stage of project development, it is critical that there is an effective cost assessment mechanism in place that avoids unduly penalising the developer for costs beyond their control. At least for large value projects, accurate benchmarking of costs across different projects is often an extremely complex process given that it is typical for each one to face a unique set of circumstances (e.g. ground conditions, planning restrictions etc.) As such, we would support the 'economic and efficient review' approach to cost assessment. There are established cost assessment processes in place under the OFTO and interconnector cap and floor regimes that demonstrate how costs can be evaluated objectively on a case-by-case basis. For CATOs, these would have to recognise the potential for significant risks to only become apparent during the preliminary works. While benchmarking / indexation can feed into this assessment process, there is opportunity to justify any legitimate cost deviations. Similarly, if undertaken in a robust way, this process protects the consumer from being exposed to excessive costs without scrutiny (e.g. under the pain/gain share mechanism).

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?*

There is potential for increased financing risk under CATO if projects are undertaken in highly geared Special Purpose Vehicles (SPVs). While commercial debt markets are adept at assessing this risk, given the critical impact that failing to resolve the network need may have on national security of supply, it would seem prudent to have an additional control in place when considering the financial structuring. To mitigate the financing risk, placing a lower limit on debt cover ratios would ensure bidders are not taking commercial debt to extreme levels.

4 Risk Allocation

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

We understand why the ESO's preferred approach is to fix the equity cost at the point of the bid. However, the cost of equity depends on the residual risk faced by the developer which is only likely to be fully understood subject to the completion of the preliminary works. As such, the extent to which bidders can effectively compete on equity cost ahead of the preliminary works stage is very dependent on the level of information that they receive in the tender, as well as their confidence in that information.

More generally, through the proposed CATO approach, the developer is required to commit to delivering the project within set timeframes with significant uncertainty over both the development risk and the outturn allowances. It is worth highlighting that this risk is greater than that faced under the OFTO and interconnector cap and floor regimes, particularly since it is more difficult for the developer to 'walk away' from the project once appointed. Such levels of risk and uncertainty may compromise the market's appetite to compete and/or the competitiveness of the bids. Having a very clear and robust framework (including appeals) for the end-to-end process may help bidders quantify the maximum level of risk that they will face in order to price that risk into their bids.

5.4 ITT (stage 1)

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

We agree that the assessment criteria outlined in the consultation is appropriate. It is important that environmental (and social) impact is included as an element to be evaluated as part of the criteria. However, documentation for the tender process should clearly outline how and what will be assessed for this category (for example, the extent to which the assessment is of the enduring solution and/or the construction process). Given that there is frequently a trade-off between cost and environmental impact of design choices, the choice of weighting between these criteria may substantially influence the proposed solution.

6.3 Operation and maintenance

30. *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 broadly agree with the proposed incentive regime. We agree that the successful bidder should be responsible for new investment, but transparent arrangements will be necessary to determine and agree the appropriate revenue stream adjustment, this will ensure that the required upgrades are financially viable.