

By email:

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Date

15th February 2021

Contact / Extension

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Dear Early Competition Team

Early Competition Plan: Phase 3 Consultation

This response is from SP Energy Networks (SPEN). SPEN owns and operates the electricity distribution networks in the Central Belt and South of Scotland (SP Distribution plc) which serves two million customers, and Merseyside and North Wales (SP Manweb plc) which serves one and a half million customers. We also own and maintain the electricity transmission network in Central and South Scotland (SP Transmission plc). As an owner of both transmission and distribution network assets, our licence obligations ensure that we must develop an economic, efficient and coordinated onshore electricity system.

We have been actively involved in the development of the Early Competition Plan (ECP) to date and welcome the opportunity to share our views on the ESO's ECP Stage 3 consultation (Phase 3 Consultation). In general, and as we have previously stated in our response dated 14 August 2020 to the ESO's ECP Phase 2 consultation (Phase 2 Consultation), we have fundamental concerns with the scale of the ESO's proposals for the ECP, 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 and therefore the ability of licensees to make their contribution to the delivery of Net Zero. These concerns are detailed throughout the Annex to this letter, which contains SPEN's responses to the consultation questions posed by the ESO in the Phase 3 Consultation.

In particular, we are disappointed that there has been little change to the ECP proposals affecting the incumbent Transmission Owners (TOs) from the ESO's Phase 2 Consultation. This is despite us submitting a detailed response to the Phase 2 Consultation on 14 August 2020 (Phase 2 Consultation Response) and engaging constructively in the series of workshops which the ESO held throughout 2020. As our concerns and issues, as detailed in our Phase 2 Consultation Response, have not been addressed in the Phase 3 Consultation, our comments in the Phase 2 Consultation Response remain. This response should therefore be read in conjunction with our Phase 2 Consultation Response.

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In addition to our responses in the enclosed Annex to this letter, we wish to offer the following comments:

The ESO's role in the development of Early Competition policy

As per our Phase 2 Consultation Response, we continue to hold the view that it is not appropriate for the ESO to be consulting on the proposed scope of the roles and responsibilities of parties involved in Early Competition models, particularly where it is proposing to extend its own responsibilities. It is therefore right and appropriate that Ofgem, as the appropriate party, will be undertaking further consultation on Early Competition, following submission of the ECP in April 2021.

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

As set out in our Phase 2 Consultation Response, it remains SPT's position that, 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.

The ESO's Phase 3 Consultation is proposing an enhanced role for the ESO in challenging the TOs' network solutions, which will shift the current balance of certain network planning responsibilities between TOs and the ESO as well as giving additional powers to the ESO to encourage and promote 3rd party solutions. These proposals could risk TOs' ability to comply with their licence obligations and their general statutory duty to properly co-ordinate the system and ensure it operates efficiently and economically.

It also remains our position that, contrary to the ESO's indications in the Phase 3 Consultation that "*the STC obligations will remain mostly unchanged for TOs and OFTOs*"¹, 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 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 their own transmission systems. 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.

We note that, notwithstanding having raised these points previously in our Phase 2 Consultation Response, the ESO's consideration in the Phase 3 Consultation of the impact on licence, statute and industry codes is limited to obligations and processes to facilitate Early Competition. This narrow

¹ Phase 3 Consultation, Chapter 8, Appendix 4, paragraph 4.2

focus of the potential impacts of the ECP on licence, statute and codes is disappointing and fails to recognise the long-term and wider implications of such changes.

Impact on achieving of Net Zero and delivering consumer value

We strongly question the extent to which the ESO has assessed its latest proposals to ensure they will deliver Net Zero on time and at the best value for the consumer. The Phase 3 Consultation suggests that the Early Competition process could take approximately 2.5 to 3 years² from the NOA assessment stage to select a preferred bidder. Further delays to project delivery seem inevitable due to the technical and commercial complexity of tendering and awarding/negotiating 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. At a time where network infrastructure is critical to the timely delivery of Net Zero, we question whether the implementation of such a model is the right solution, given the unprecedented amount of network infrastructure required to be delivered to align with the Net Zero ambitions of the UK and devolved governments.

The ESO's annual Network Options Assessment (NOA) outcomes show the scale and cost of the transmission infrastructure that is required to facilitate the Net Zero transition. For example, NOA5 (2019/20) indicated the need for **three** Eastern HVDC Links from Scotland to England. NOA6 (2020/21) recommends a **fourth** Eastern HVDC Link. Overall, schemes recommended to 'Proceed' by NOA6 (2020/21) result in a total investment cost in the SPT area of £2.34bn³ over the next 13 years, an increase of £1.29bn on last year. Using these NOA outcomes as precedent, we are not confident that the current Early Competition model proposed by the ESO will be able to deliver such infrastructure on the timely basis which it is needed.

We also question how this work aligns with the ongoing BEIS/Ofgem Offshore Transmission Network Review and whether the introduction of Early Competition models to the delivery of offshore transmission infrastructure will further complicate, already complex, proposals increasing the risk of costs and delays to both offshore generators and consumers.

Despite the detailed work that has been undertaken to develop the ECP framework proposed in the Phase 3 Consultation, we have yet to be provided with any cost benefit analysis (CBA) or impact assessment (IA) which demonstrates the consumer benefit in introducing Early Competition. Whilst we accept that Ofgem did not request such information of the ESO in the development of the ECP, this is a major failing in the process. Introducing lengthy delays into the delivery of major Net Zero infrastructure is to the detriment of consumers and generators alike, especially when taking into consideration the huge constraint costs that the ESO are forecasting if key strategic infrastructure is

² Phase 3 Consultation: Chapter 5, End to end process, page 5

³ Assumes SPT delivers 50% of HVDC works in both HVDC links

delayed. For example, analysis in 2019 showed a one-year delay on the first Eastern Link would cost GB consumers an average of £330m in constraint costs⁴.

Such lack of evidence, if not obtained by Ofgem, would risk the implementation of an Early Competition model being driven by ideology, which could compromise genuine consumer value and the timely delivery of Net Zero. This would undermine not only the regulatory model, RIIO, which is designed to ensure consumers are afforded best value, but also Ofgem's principle objective under Section 3A of the Electricity Act 1989 to *"protect the interests of existing and future consumers in relation to electricity conveyed by distribution or transmission systems."* We therefore believe it is critical that Ofgem undertake this CBA and IA work before Ofgem takes forward any further consultation on the ECP, following submission of the ESO's ECP proposals in April 2021.

The removal of any value threshold for projects to be delivered via Early Competition models

As explained in our Phase 2 Consultation Response, the ESO's 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. 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. Furthermore, it remains the case that for both the RIIO-T2 and RIIO-ED2 frameworks, Ofgem is suggesting that there should be a minimum value threshold of £50m for Early Competition models, although further consultation will be undertaken. 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, particularly as no CBA or IA work has been undertaken by the ESO to date. It also remains entirely unclear why the ESO would seek to depart from Ofgem's position on this.

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 future network projects will potentially be subject to 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 <https://www.nationalgrideso.com/document/137321/download>

TOs acting as the counterfactual in Early Competition

As detailed in our Phase 2 Consultation Response, 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, 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 underpin the effective operation and maintenance of 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.

Both ourselves and SSEN Transmission have continually reiterated our position that the incumbent TO should be treated as the counterfactual position, against which market bids are measured. Only then can we be truly confident that a market-led proposal delivers greater consumer benefit compared to the status quo arrangements under the RIIO framework. It is disappointing that the ESO has not included the option of the TO competing as a counterfactual as part of its deliberations on the ECP. The ESO first formally engaged with ourselves and SSEN on the matter of exploring what the counterfactual position could look like, post-publication of the Phase 3 Consultation. This is regrettable as it has meant we have not had the opportunity to formally respond to this alternative solution and to address the perceived risks that the ESO sees with the counterfactual approach.

We welcome the fact that Ofgem is to further consult on the roles and responsibilities of the various parties involved in Early Competition, following submission of the ECP to Ofgem in April 2021. As part of this consultation exercise, we expect Ofgem to formally consult on the counterfactual solution as part of any Early Competition framework. Part of this work must also include the development of transparent and robust CBA processes which, accurately and fairly, measure the consumer value and system benefits of long-term regulated network assets, against potentially shorter-term market solutions. Such a process will not only benefit any Early Competition processes but also the existing Pathfinder competitions. It is only then, when such a robust CBA model exists, can we be truly confident that a market-led proposal delivers greater consumer benefit to the status quo arrangements under the RIIO framework.

Extending Early Competition into Distribution

It is our reading that the current proposals are for the Transmission sector only. If Ofgem do intend on introducing Early Competition into the distribution sector, then we would expect a robust and thorough consultation process to be carried out for a model that is specific to the distribution sector, with a separate IA and CBA detailing the consumer benefit of doing so.

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Regarding the Phase 3 Consultation, we believe that the ESO have reached the correct decision in concluding that there is no role for the ESO to play in Early Competition if it were extended into the distribution sector. Ofgem will develop the role of the DSO alongside the ED2 framework which we believe will clarify the place of Early Competition in the distribution sector. Any work done before this would be premature.

Please find our detailed response to each of the consultation questions in the enclosed Annex.

Yours sincerely



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