nationalgridESO

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Delivered via email

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Early Competition Plan ("ECP")

Dear Akshay,

In helping deliver the Government's commitment to net zero carbon emissions and in support of our ambition of competition everywhere, we're working with industry to transform the way Great Britain's electricity system is designed and built. We know the energy transition must be affordable and competition is vital for encouraging innovation and keeping prices as low as possible. Working with partners from within and outside the energy industry, we have considered how early competition can be introduced into developing and running our electricity networks. This means organisations can compete for the design, build and ownership of solutions to meet transmission system needs. Early competition could help drive innovation across the lifecycle of the solutions right from the early design stages, with the potential to deliver millions of pounds in savings for consumers.

Our latest Network Options Assessment ("NOA") publication sets out the asset investment required across the GB Transmission Network over the next ten years. As an indication, assessing these projects against the criteria for early competition we believe there are 21 projects, with a combined value of >£2.6bn, which could potentially be suitable for early competition[1]. While historic trends are not a predictor of future, the continued growth in renewable generation, as set out in our Future Energy Scenarios, is likely to continue to drive need for network investment[2]. We would also anticipate further opportunities arising from consideration of early competition in the delivery of solutions to voltage and stability requirements in addition to new connections and asset replacement.

As requested by Ofgem in the May 2019 Sector Specific RIIO-2 Decision Document we have compiled an ECP. This plan sets out our proposals for early competition, roles and responsibilities of parties to facilitate an early competition and the timescales and pathway for implementation.

Stakeholder input into the development of our ECP has been highly important in ensuring that the proposals we put forward should deliver value for consumers and remain attractive for potential bidders. In developing the plan, we have sought stakeholder views through several mechanisms. This has included workshops, bilateral conversations, webinars and consultations. We also established a stakeholder challenge group to ensure our stakeholder engagement was robust and our proposals do not unfairly favour one stakeholder group over another. We'd like to thank stakeholders for taking the time to engage with us as we developed these proposals and the ESO Networks Stakeholder Group for their feedback.

Structure of ECP

The ECP is structured into 3 documents and supporting appendices. The first is the main ECP which sets out our proposals for an end-to-end model of how early competition could be run, implementation timescales and activities and our view of the roles the ESO could perform. We also highlight areas of the proposals where we

[1] Projects would need to undergo a specific cost benefit analysis to confirm whether consumer value could be driven from competing delivery.
[2] Refer to ETYS 2020 https://www.nationalgrideso.com/research-publications/etys-2020

have received differing stakeholder views and areas where challenges remain to be resolved but are best addressed in the implementation phase.

The second document, Developing the ECP, sets out our approach to stakeholder engagement throughout the development of the ECP. It also sets out our approach to governance and quality assurance, demonstrating that the proposals presented have been developed through an appropriate structured, transparent and collaborative process. This document is supported by a number of appendices which set out in greater detail our engagement approach, stakeholder feedback, (including the report from our stakeholder challenge group), and how we have acted on the feedback received.

The third document, ESO Role in Distribution, considers whether the model developed for transmission can be applied to, and whether there is a role for, the ESO in early competition in the distribution sector. Given the more conceptual nature of the ask on early competition in distribution we have included this as a separate high-level thought piece.

Summary of key challenges of implementing early competition

The development of early competition is complex. Competing projects at an early stage in the project development lifecycle, whilst allowing greater scope for innovation, presents challenges with managing the inherent uncertainty associated with projects at this stage.

In developing our proposals, we have sought to achieve a balance between creating an attractive proposition and protecting consumers. Key to this is creating a tender process which is fair and transparent. Achieving this will require appropriate management of perceived and real conflicts of interest of parties involved in running and facilitating early competitions, along with appropriate allocation of risks. We see a number of key challenges in implementing early competition, which will need to continue to be addressed as work moves forward in this space. These are:

- **The involvement of incumbent TOs in the competitive process** – this includes whether incumbent TOs are allowed to compete and if so, how potential conflicts of interest with their role in network planning can be managed. This is one of the key areas of our proposals where stakeholder views are wide ranging. Our proposals are for TOs to compete on the same basis as any other party for the same Tender Revenue Stream. With regard to conflict mitigation we had proposed that mechanisms similar to those Ofgem set out as being required for the introduction of late competition in 2016[3] would be proportionate. However, noting some stakeholder concerns and following publication of Ofgem's Review of GB System Operation we now believe it is appropriate to consider the roles of the ESO and TOs in network planning in the broader context of BEIS consultation on institutional arrangements
- **Ensuring tender process and contract/licence fairness for network and non-network solutions** – part of the driver for early competition is the ability to attract a wider range of innovative solutions, considering both network (those that fulfil the definition of electricity transmission) and non-network solutions. Bidders would win either a contract or an electricity transmission licence from an early competition depending whether they are respectively a non-network or network solution. Licences allow for greater recourse actions in the event that solutions fail to deliver at any point post tender award. Further, due to differences in the types of solution, some conditions which are prevalent in a transmission licence may not be appropriate to a contracted solution. If early competition is implemented careful consideration to the development of CATO licences and early competition contracts will be required to ensure that appropriate and fair measures are applied to each potential type of solution provider
- **Ensuring post preliminary works cost assessment methodology, adjustment cap and performance bonds are viable** – we have recommended these as part of our proposals to retain competitive pressure and protect consumers. As solutions are being competed at a concept design stage there are significant uncertainties inherent at the early stages of the project lifecycle. To avoid excessive risk being priced into the bids (and consequently not delivering consumer value) we are proposing a post preliminary works cost assessment process to allow for some cost change for events which could not have reasonably been foreseen. However, to protect consumers we are also proposing a cap to this adjustment in order to ensure that bidders properly consider risk mitigation ahead of bidding. Stakeholders have expressed concerns on the cap and size of performance bond. We have modified our proposals in response to the feedback however, these would need to be considered further during any implementation phase as to

[3] Extending competition in electricity transmission: Decision on criteria, pre-tender and conflict mitigation arrangements: https://www.ofgem.gov.uk/system/files/docs/2016/11/ecit_november_2016_decision.pdf

what an appropriate level is to provide additional consumer protection without making the competition unattractive

- **Development of bespoke procurement legislation** – given the nature of the competition and the proposed post tender cost assessment process, early competition, whilst adhering to the principles of Utilities Contract Regulations (UCR) would not be compliant with all the requirements of the UCR. Specific procurement regulations would be required, as is the case for OFTO competition. These are not yet drafted. The content of this legislation will have an impact on the roles and responsibilities of parties facilitating early competition and in particular on the Procurement Body.

Summary of the state of the market

The state of the market for early competition is driven by a number of dimensions. We undertook a high-level assessment of potential investor pools that could be interested in participating in the early competition. The assessment was based on existing market insight and stakeholder engagements. Overall, projects based on Public Private Partnership ("PPP") models such as OFTOs and existing private finance infrastructure assets across sectors, are able to attract a strong pool of bidders due to the maturity of the asset class. These assets have standardised tender and contractual arrangements set in place. The NOA high voltage and stability pathfinder projects were also able to attract a large number of bidders (each attracting 8 and 10 bidders in the bidding process). While there is a strong appetite to invest in the UK infrastructure assets, the technical and project specific risk characteristics of a given project will have a material impact on its attractiveness and determine willingness by different types of investors to participate in the relevant procurement. For instance, the market engagements completed to date for various DPC projects in the water sector (which have some similarity to the CATO model) have shown a strong stakeholder interest in the near-term horizon projects. However, many of the commercial details for DPC are still to be developed. The balance of risk and reward would drive bidder appetite to participate in the competition and their willingness to put resources and capital at risk. It is expected that bidders will look at key issues and risks such as bidding costs, project complexity and available lead time to assess whether the potential return, benefits and probability of winning a project under the early competition will outweigh potential costs arising from the risks occurring.

Recommendation on whether to implement early competition

Given a general rule of thumb that approximately 75% of a project's costs are set in the initial concept design phase there is significant scope for driving consumer value from early competition. As an example, offshore competition – a form of very late competition conducted once assets are already constructed - has delivered between 19-23% consumer savings[4]. Ofgem estimated potential savings of 4-19% from a late CATO SPV model. A 2019 report[5] found that in the US cost savings from competition averaged 20-30% compared to the initial price.

Early competitions as set out in our proposals is estimated to be in the region of £4.8m to £6.3m to implement. The cost of running competitions in part will vary with the project size and complexity, but with a portion of the cost being fixed regardless of size. For a £250m project we estimate the cost to run a tender of between £4m – £5.75m (1.6% to 2.3% of project value). We would expect the cost of initial tenders to be higher than for subsequent ones as the process matures and efficiencies are delivered. Taking projects out of the annual NOA process may however lead to inefficiencies. This stems from the ability of the TO in the NOA process to evolve the solution year on year based on the changing needs. While projects taken through a competitive delivery process would undergo a periodic assessment to ensure they are still delivering consumer value, the need they are seeking to address is fixed at the tendering point which could be earlier than the current NOA proceed signal. Consideration also needs to be made to the impact of increasing the number of onshore TOs on the efficacy of coordination.

Taking into account some of the limitations of running a competitive process, based on the type of projects we see being suitable for early competition and the costs to run it, our view at this time is that the introduction of early competition does appear to be in the interests of consumers. Further consideration however is required from Ofgem as to whether the limitations of introducing competition would, in the longer term, outweigh the potential benefits.

[4] Evaluation of OFTO Tender Round 2 and 3 Benefits (https://www.ofgem.gov.uk/ofgem-publications/99546)
[5] https://www.brattle.com/news-and-knowledge/news/report-by-brattle-economists-discusses-the-benefits-of-competitive-transmission

The ESO's role in early competition

We recognise the importance of the role the ESO has to play in facilitating competition. The ECP proposes that National Grid ESO may be the most appropriate industry participant to perform one or more of the roles that will be required to implement the early competition model. While these roles build on existing capabilities to an extent, they would also add new activities and expand our role. As such, when the model is finalised and should Ofgem recommend that the ESO fulfil a particular role, the board and shareholder of National Grid ESO would need to consider whether it was appropriate and able to take on the particular role or roles.

The recommendations set out in this ECP are our best view of a model for early competition. Further development of proposals and engagement with stakeholders will be required along with development of appropriate legislation, licence(s) and code changes in any subsequent implementation phase. We would like to thank stakeholders for taking the time to engage with us in developing these proposals. Their feedback has been instrumental in shaping our plans set out here. If you have any questions on this ECP please contact Hannah Kirk-Wilson (Hannah.Kirk-wilson@nationalgrideso.com).

Yours sincerely

Matthew Wright

Head of Strategy and Regulation