

 Regulatory Policy Committee	Opinion	
Impact Assessment (IA)	Extending competitive tendering in the GB transmission network	
Lead Department/Agency	Department for Energy and Climate Change	
Stage	Consultation	
IA Number	Not Provided	
Origin	Domestic	
Expected date of implementation	SNR 11	
Date submitted to RPC	26 March 2015	
RPC Opinion date and reference	8 May 2015	RPC15-DECC-2350
Overall Assessment	GREEN	
<p>RPC comments</p> <p>The IA is fit for purpose. The Department has identified the main impacts of the proposal and has monetised these where possible, highlighting the overall uncertainty and critical assumptions made. At final stage the Department should include the set up costs to Ofgem, which is industry-funded, as a direct cost to business or explain why, in this case, it is not appropriate to do so. The IA includes a sufficient assessment of the impacts on small and micro businesses.</p> <p>The OITO assessment appears to be reasonable. The Department has provided sufficient evidence to justify its assessment of the proposal as pro-competition. It could, however, at final stage, explain more explicitly why the entire proposal, including ancillary changes, qualifies as a pro-competition measure in line with paragraphs 1.9.17-1.9.19 of the Better Regulation Framework Manual (March 2015).</p>		
<p>Background (extracted from IA)</p> <p>What is the problem under consideration? Why is government intervention necessary?</p> <p><i>Significant investment is needed over the coming years to ensure that Britain's electricity networks support a secure, sustainable and affordable energy supply, whilst also delivering value for money for consumers. Nearly a quarter (24%) of the average electricity bill in 2014 was made up of the cost of transporting electricity from the place that it was generated to the customer. It is imperative to look for opportunities to bear down on these costs and reduce those being passed through to consumers.</i></p> <p><i>In 2009, the Government introduced legislation that enables competitive tendering for the right to own and operate transmission infrastructure that connects offshore generators like</i></p>		

windfarms to the mainland. The regime has proved a success, and has brought significant costs savings for consumers.

The Government are considering extending this competitive regime to the onshore transmission network. This would mean that the right to develop and operate certain onshore assets would no longer be given automatically to the regional monopoly operator, but would instead be awarded to the bidder with the most competitive offer. This would address market power and barriers to entry currently present in onshore transmission assets. It would also address the information asymmetry between Ofgem and the companies it regulates. There are also positive externalities associated with competition, for example on long term innovation benefits, which can be unlocked. Extending the competitive regime requires primary legislation.

What are the policy objectives and the intended effects?

To extend competitive tendering to areas of the onshore transmission network where it is efficient and cost-effective to do so and thereby contain the cost of network investment in order to limit cost rises being passed through to consumers. Based on the experiences of the offshore competition regime and taking into account tender costs incurred by Ofgem, we estimate that the introduction of this system could provide overall net estimated savings of 11% against the asset value in the status quo. In addition, competition should bring long term innovative advantages such as new technological solutions, more investment in research and development, and an increase in the positive impacts from learning-by-doing. It should also encourage new players into the market, improve performance, and reduce the costs passed through to consumer bills.

Identification of costs and benefits, and the impacts on business, civil society organisations, the public sector and individuals, and reflection of these in the choice of options

The Department proposes to make changes to primary legislation, enabling Ofgem to extend its competitive tendering system for offshore transmission assets to the onshore market. Competitive tendering is not considered to be cost effective for all types of onshore transmission assets. In addition, increased competition could have an adverse effect on costs as transmission owners can act as natural monopolies and benefit from economies of scale. The Department intends to address this by setting out suitable criteria that will determine which transmission assets will be subject to tendering. Currently, the Department anticipates that the criteria will be that the asset has to be new, of high value and separable from the rest of the network.

There are currently three onshore transmission owners acting as regional monopolies: National Grid Electricity Transmission in England and Wales, Scottish Power Transmission in the south of Scotland and Scottish Hydro Electric Transmission in the north of Scotland. National Grid also operates as the system operator, responsible for directing and coordinating the flow of electricity across the system. Transmission owners are regulated through transmission licences granted by Ofgem and submit business plans to Ofgem, outlining necessary expenditure and investments. These plans are scrutinised by Ofgem, which will, in response, determine a set of measurable outputs transmission owners are expected to deliver and determine the appropriate funding level.

As the proposal is a change to primary legislation, enabling Ofgem to extend competitive tendering to onshore assets through secondary legislation, it does not have any immediate effects in itself. The Department, nevertheless, correctly provides analysis and estimates of the potential effects of the policy.

Impacts on Ofgem

Ofgem estimates set-up costs related to developing and establishing the legal and operational frameworks of between £2 million and £3 million. The Department estimates staff and resource costs associated with running the tendering process and evaluating bids to be 1% of the asset value. Costs and benefits of the proposal depend on the future level of investment in the transmission network and the related frequency of tendering processes. Given the level of uncertainty of future investments the Department estimates costs of running the tendering process to be £0 - £65 million over 10 years (present value).

Impacts on businesses

Incumbent transmission owners and potential new entrants will face bid costs, estimated to be £0 - £130 million over 10 years (present value).

The Department explains that some incumbents will experience asset and profit losses as they are unsuccessful in the tendering process. These losses are assumed to have only a distributional effect as the assets and resulting revenue streams will transfer to successful new entrants. The Department acknowledges that the underlying assumption that the returns derived by new entrants under competitive tendering will be the same as returns to incumbents in the status quo has to be caveated. It is not clear whether revenues to new entrants will be smaller, because they are derived under a form of competition rather than in a monopolistic setting, or larger, because new entrants are incentivised to outperform anticipated costs.

The system operator might experience additional interface costs because it has to interact with more parties. As the system operator already interacts with a broad group of industry parties, the Department expects any such increase in costs to be negligible.

The Department considers bid costs to businesses as well as the recovery of Ofgem's tendering costs as direct impacts of the proposal. It is not clear why the IA does not treat set up costs faced by Ofgem in the same way. In principle such costs would be direct, even though they may not impact the eventual EANCB figure in this case, because the measure appears to qualify as pro-competition and, therefore, classify as zero net cost.

Effect on consumers/overall benefits

The Department explains that it expects competitive pressure to reduce costs in the sector, which should ultimately be passed through and benefit consumers. Based on its experience in the offshore sector, it estimates that these cost savings could be between £0 and £775 million over 10 years (present value). It explains that it is not clear to what degree estimates, based on the offshore experience, translate to the onshore sector.

Comments on the robustness of the Small & Micro Business Assessment (SaMBA)

The proposals increase the scope of regulation on business. A SaMBA is, therefore, required.

The SaMBA is sufficient. The Department explains that there are no small or microbusinesses currently operating in the transmission sector. The current incumbent transmission owners – National Grid Electricity Transmission, SP Energy Networks and Scottish and Southern Energy – are large businesses. Operators of offshore transmission assets which secured their licences through the competitive process introduced in 2009 are all special purpose vehicles consisting of consortia of large businesses, comprising large generators, transmission owners, and financial institution investors. The legislation proposed does not introduce any additional burdens on small or micro-businesses. Instead, it lifts a potential barrier to small and micro-businesses entering this market.

Comments on the robustness of the OITO assessment.

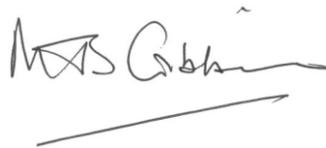
The IA provides an assessment of costs and benefits to businesses that could arise from this policy as a whole. The RPC accepts that the primary legislation alone does not have any impact on business at this time.

The Department considers that the proposal will be in scope of OITO as it concerns the regulation of business. The Department explains that the primary aim of the policy is to create benefits by increasing competition in the sector and that the proposal should be classified as a pro-competition measure and scored as an IN with zero net cost in accordance with the Better Regulation Framework Manual (paragraph 1.9.15).

The IA includes an assessment against the four criteria outlined in paragraph 1.9.16 of the current manual. The Department explains that competitive tendering is likely to increase the number of businesses in the market for onshore transmission assets and to increase the level of competition between businesses. It provides estimates of the social benefits of the proposal, which are based on its experience in the offshore sector. The assessment of this proposal as pro-competition appears reasonable based on the evidence provided by the Department.

Only impacts specifically related to competition aspects of a proposal can be classified as zero net cost. The Department should, at the final stage, explain more thoroughly how the ancillary changes to legislation are necessary for increasing competition and how the proposal in its entirety can, therefore, be classified as zero net cost. Any direct impacts should be scored at the implementation stage.

Signed



Michael Gibbons, Chairman