

## **Extending competitive tendering in the GB electricity transmission network**

**Department of Energy and Climate Change**

**RPC rating: fit for purpose**

### **Description of proposal**

The Department proposes to enable the Office of the Gas and Electricity Market Authority (Ofgem) to auction the right to operate the electricity transmission infrastructure that connects *onshore* generators to suppliers. A similar process was previously conducted for *offshore* transmission mechanisms.

The National Electricity Transmission System (NETS) links electricity generators to suppliers across Great Britain, her territorial seas and the wider Renewable Energy Zone. The NETS consists of three integrated transmission networks, each of which is owned by one of three transmission operators (TOs). These are National Grid Electricity Transmission (NGET) in England, Scottish Power Transmission in the south of Scotland and Scottish Hydro Electric Transmission in the north of Scotland. Each TO operates as a regional monopoly, so the system is regulated by Ofgem in order to ensure efficiency and protect consumers through a price control mechanism.

The licence to operate a transmission mechanism is currently automatically given to the relevant regional monopoly operator. In order to retain this licence under the proposal, the operator will have to bid against other TOs and new entrants to the market. The bidding process will take the form of a reverse price auction, with bidders also being assessed on their relevant experience; their ability to raise the requisite level of project finance; the robustness of their approach to asset management; and the costs they propose for operating and maintaining the asset.

### **Impacts of proposal**

The Department assumes that the costs associated with competitive tendering in the onshore market will be similar to those in the offshore market. While this is consistent with the best available evidence, the Department recognises some limitations in this assumption. These costs are in the form of:

- One-off set-up costs associated with creating the competitive regime. These will be imposed as a direct cost on operators as it will be recovered through their licence fees. They will be recovered in turn from generators and suppliers, who are expected to pass them on to end consumers. The Department estimates this one-off cost at £3 million.
- Tender costs associated with running each competitive tender. While initially incurred by Ofgem, they will be recovered from the successful bidder. The costs in each case will depend on the value of the licence being tendered. These are eventually expected to be passed on to generators, suppliers and consumers. However, the Department expects direct tender costs to business of up to £10 million each year.
- Bid costs are incurred in the first instance by incumbent transmission owners and new entrants. These are direct costs to those businesses, however, only the winner's bid costs contribute to EANCB calculations as, in line with the rules set out in the Better Regulation Framework Manual the loser's costs are considered to be permissive costs. The Department estimates bid costs of up to £20 million per year dependant on the number of licences tendered.

The Department expects the proposal to be net beneficial. The tendering process will only select bidders that are able to deliver a more cost-effective service and have committed to certain profit ratios allowing for a substantial amount of profits to be passed on to consumers. Although some of the above costs are also expected to be passed on to consumers, the successful bidder will have already demonstrated their ability to provide a greater reduction in operating costs than the amount of cost associated with the tendering process. They will also be subject to a project-specific price control which will set out the allowed revenue associated with the assets and a range of requirements and outputs against which the bidder must deliver. Within this price control, Ofgem will ensure the incentive for TOs to innovate remains; as the additional profits will be shared between themselves and consumers at a previously agreed rate.

Ofgem will also benefit from the information on operating costs received in the tendering process as this can be used to conduct more effective price control on the assets that are not being tendered. These savings will also be passed on to consumers.

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## Quality of submission

The Department has assessed the proposal as a pro-competition measure that will be a non-qualifying regulatory provision in relation to the Business Impact Target. On the basis that the measure satisfies all of the four criteria set out in the Better Regulation Framework Manual (paragraph 1.9.16), and on the basis of current working assumptions, the RPC is able to confirm this assessment. By tendering contracts, the policy is directly increasing the range of potential sustainable suppliers that are competing for the market. However, the additional information provided by the Departments on the mechanics of the bidding process should be included in the IA.

A critical test for pro-competition is whether the measure has a net benefit to society. The Department provides a range of five scenarios, all of which result in a net social benefit that ranges from £215 million to £760 million, other than in one unlikely scenario. The only scenario with a net cost to society is if there are no competition effects and a net cost to society of £3 million. As this scenario is unlikely and is being used as a worst case scenario, it is reasonable to assume that the policy will result in a net benefit to society. Therefore, the RPC is able to validate the measure as a pro-competition measure. To quantify the impact of the tendering process in its five scenarios, the Department has drawn from external research on the competitive tendering process in the offshore electricity transmission market. The Department could have provided a more detailed explanation of why it has used the third scenario as the best estimate. It appears the third scenario was chosen by default as it is the middle scenario. Nevertheless, the range of scenarios does not affect the pro-competition nature of the proposal.

The Department estimates that the net cost to business each year will be on average £7.8 million. Due to the long term nature of the proposal, the Department's use of a 30 year discount period is reasonable, as a tender that is issued in 10 years' time may yield benefits for up to 20 years after the issue date.

When calculating the net cost to business the Department assumes that any reduction in revenue caused by more competitive pricing will be roughly equal to the reduction in costs in a more competitive market. Although this assumption has limitations, the Department has recognised this by stating that the profits may in fact be smaller as they are derived from a more competitive market, or larger as firms face incentives to improve on anticipated costs. As it is hard to identify which of these pressures will dominate, any attempt to quantify would be unreliable; thus the Department's assumption appears to be a fair approach.

## Small and Micro Business Assessment

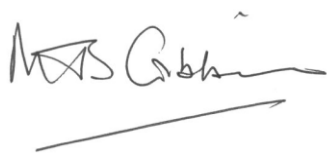
The small and micro-business assessment is sufficient. The Department explains that there are no small or micro-businesses currently operating in the transmission sector. The policy option proposed here does not introduce any additional burdens on small or micro-businesses.

### Initial departmental assessment

Classification	In scope
Equivalent annual net cost to business (EANCB)	£7.8 million
Business net present value	Not provided
Societal net present value	Not provided

### RPC assessment

Classification	Non-qualifying regulatory provision (pro-competition)
EANCB – RPC validated	Zero for reporting purposes
Small and micro business assessment	Sufficient



**Michael Gibbons CBE**, Chairman