



Department for
Business, Energy
& Industrial Strategy

Competition in Onshore Electricity Networks

Government Response to Consultation on
Competition in Onshore Electricity Networks

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Contents

Introduction	4
Executive Summary	5
Decisions Made	9
Question 1: When to determine the type of competition to be utilised, if any	11
Question 2: Key factors when assessing bids	18
Question 3: Market Barriers, types of solutions, types of bidders	21
Question 4: Appointing a Body to run tenders	28
Questions 5&6: Views on appointing Ofgem, National Grid Electricity System Operator or others for competitions at transmission level	32
Question 7: High value threshold for late-model competition at transmission level	38
Question 8: Competition Criteria for late-model competition at distribution level	41
Question 9: Views on the appointed body at distribution level	43
Other Comments and Themes	46
Impact Assessment	46
Competition that already exists	46
Whole system thinking, holistic system designs and network planning	47
Comparison with competition in retail market	48
Conclusion and Next Steps	49
Glossary	50

Introduction

We committed in the 2020 Energy White Paper to enable competitive tenders for the build, ownership and operation of onshore electricity network. It was announced in the May 2022 State Opening of Parliament that Her Majesty's Government 'will bring forward an Energy Bill to deliver the transition to cheaper, cleaner, and more secure energy' and we have introduced the Energy Security Bill to Parliament, delivering on this commitment.

Allowing new parties to compete for onshore electricity network projects will deepen the pool of capital available for the significant amount of investment needed in our electricity networks as we transition to net zero. Competitive pressure in electricity networks is expected to improve efficiency, saving consumers more money, and encourage further innovations in system design and operation.

We consulted in August 2021¹ on a range of questions that relate to the implementation of the onshore electricity competition framework. This document summarises the responses that we received and sets out the Government position in relation to those questions.

We received a total of 31 responses, from a range of stakeholders, including network companies, developers, generators, investors and others.

Many responses were comprehensive and discussed a variety of issues that impact the introduction of onshore competition. This includes comments on the need for certainty, how competition impacts on the electricity system as a whole, and consideration on how early-model competition will work in practice.

This document will set out summaries of the responses that we received and explain the reasoning for each decision taken. We also elaborate in our response to Question 1 on the commitment made in the British Energy Security Strategy that certain strategic transmission projects will be exempt from the introduction of onshore competition.

¹ BEIS *Competition in Onshore Electricity Networks Consultation* (2021)
<https://www.gov.uk/government/consultations/competition-in-onshore-electricity-networks>

Executive Summary

Against the background of a rapidly evolving electricity system, we committed in the Energy White Paper 2020 to legislate to enable competition in onshore electricity networks (or ‘onshore competition’). Taking account of this evolving landscape, we are eager to create a competitive framework which can be adapted to suit the system needs. The Energy Security Bill sets out the legislative measure that the Government is proposing to enable this. The Energy Security Bill was introduced to Parliament on 6th July 2022.

The Competition in Onshore Electricity Networks consultation asked 9 questions, focusing on how the competitive framework will be implemented in the electricity network market. This response sets out the decisions that Government have made on the points we consulted on, following consideration of the responses received.

Since our consultation closed, Government has also set out in the British Energy Security Strategy that certain infrastructure will be exempt from the introduction of onshore competition, to ensure that the period of transition to a competitive process for network delivery does not slow down our progress towards our energy security and decarbonisation objectives. We elaborate on this commitment in our response to Question 1.

One: When to determine the type of competition to be utilised, if any

The type of network need at hand can affect the types or range of solutions available to solve them. As such, we consider that the onshore competitive framework should allow for types of competition most suited to the network need, whether it be early-model competition or late-model competition. To provide certainty for those planning networks and potential bidders, we suggested it would be appropriate for Ofgem to publish a decision on the type of competition, if any, to be utilised on any given constraint as part of the needs case assessment. We asked respondents for views.

Our decision: In this response, we set out further information on how the exemption announced in the British Energy Security Strategy will work in practice. **Certain strategic projects which are likely to engage in the market between now and 2026 will, where it is in consumer interests, be exempt from the introduction of onshore network competition.** This will help reduce the impacts of uncertainty about when competition will be in force and reduce the likelihood of adversely impacting delivery timelines for strategic projects that are key to delivering on targets such as our 2030 offshore wind target, during the period in which competition is implemented. **Ofgem will publish a consultation that includes a list of projects that it considers should be exempt and will publish its final decision by the end of 2022.**

Other than in respect of initial exempted projects, we expect competition to become the norm and to be incorporated into network companies’ project plans from the outset so the need for exempting strategic projects will no longer apply. Individual projects will be considered for their eligibility for competition using criteria set by the Secretary of State, and Ofgem will publish a

Competition in Onshore Electricity Networks

decision on the type of competition model to be used on any given network need at the earliest suitable opportunity²:

- In the case of early-model competition, the network need would be assessed against the early-model criteria³ once the Electricity System Operator modelling identifies it (currently at the Network Options Assessment (NOA) signal). Ofgem has recently confirmed it is minded that this should be through the Centralised Strategic Network Plan in future⁴.
- In the case of late-model competition, this will be, at the latest, by the point at which Ofgem makes its final approval of the proposed design, currently referred to as the Final Needs Case Assessment under Large Onshore Transmission Infrastructure in RIIO-2.

Ofgem will set the process for establishing eligibility for competition as part of agreeing the next transmission price control.

Two: Key factors when assessing bids

When we consulted, we said that to gain the benefits of true competition, any competitive regime to address network needs should be open enough to allow new types of solutions to bid in. This allows for innovation and new markets to emerge by allowing different solutions to compete against one another in the market on a level playing field. We asked, to enable fair consideration of flexible and traditional solutions under a competitive framework, what respondents felt were the key factors that should form part of the Appointed Body's assessment of bids in the tender process.

Our decision: **The factors that will be taken into account in assessment of bids in competition will be set out in the Invitation to Tender documentation and the Tender Regulations developed by Ofgem and the Appointed Body.** We consider that these should be set in a solution-agnostic and location-agnostic way, and so these factors will need to be prioritised and weighted to suit the project at hand.

Three: Market Barriers, types of solutions, types of bidders

Related to this same issue about competing different types of solutions, we asked whether there were any market barriers to smart, flexible solutions being competed alongside traditional solutions in a fair and open competitive process. We noted that it would be useful to understand the types of bidders interested in such competitions, and the types of solutions they might put forward for consideration.

Our decision: We welcome the interest in participating in competitions from a range of respondents, and the generally held view that traditional wire solutions and smart, flexible solutions, can and should compete against one another. **Ofgem will provide information on**

² See Government Analysis section for further details.

³ For more information on the criteria for early-model competition, see Ofgem *Early Competition Decision* (2022) pp.29-34 https://www.ofgem.gov.uk/sites/default/files/2022-03/Early_Competition_Decision_Final.pdf

⁴ Ofgem, *Consultation on our minded-to decision and draft impact assessment on the initial findings of the Electricity Transmission Network Planning Review* (2022)

what licensing arrangements, if any, the winning bidder will be subject to, as part of setting the Tender Methodology.

Four: Appointing a Body to run tenders

As set out in the consultation, the Secretary of State should be able to appoint bodies they deem suitable to run competitive tenders. We listed the factors that the Secretary of State may consider when considering appointing a body, including (but not limited to) independence, economies of scale and technical proficiency. We asked if respondents agreed that these were the right factors.

Our decision: When appointing a body (the “Appointed Body”⁵) to run tenders for competition, we propose that the Secretary of State consider, among other things, the factors, both essential and desirable, as set out in the consultation.

Five and Six: Views on appointing Ofgem, National Grid Electricity System Operator (NGESO) or others for competitions at transmission level

At the time of consultation, we set out why we consider that Ofgem and NGESO are currently the only two bodies that we view as being potentially suitable for taking on the role as Appointed Body for onshore competitions. We asked (5) if respondents had views on the suitability of Ofgem or NGESO as a possible Appointed Body; and (6), if there were any other bodies that should be considered as a possible Appointed Body, and why.

Our decision: In exercising their power to appoint an Appointed Body, we propose that the Secretary of State appoint NGESO to the role of the Appointed Body for onshore competitions at transmission level, with a view that this function will eventually be transferred to a Future System Operator. The legislative framework will need to ensure that the Appointed Body will work closely with Ofgem, who will oversee the competitive process. This is not a final decision and will be subject to the Secretary of State’s discretion at the time of the appointment.

Seven: High value threshold for late-model competition at transmission level

For late-model competition, we envisage that the criteria for identifying projects that are suitable for competition will be those where the incumbent’s indicative solution is an asset that is new and separable from the existing network, and of high value. Ofgem have previously issued guidance that states high value means over £100m. We asked if respondents agreed that £100m remains the appropriate threshold to be ‘high value’, assuming this criterion is applied to late-model competition in electricity transmission.

⁵ This consultation response refers to an “Appointed Body” because this is the language that was used during the consultation and in responses from stakeholders. The Energy Security Bill refers to the designation of a “delivery body”. For all intents and purposes, the “Appointed Body” and “Delivery Body” are the same entity, and any reference in this document to “Appointed Body” can be read as the same as “Delivery Body” in the Schedule 12 of the Energy Security Bill.

Our decision: **We consider that a high-value threshold of £100m is the correct point for the competition criteria, in the context of late-model competition at transmission level.** We will keep this under review as the competitive market becomes more established.

Eight: Competition Criteria for late-model competition at distribution level

Our legislative framework will enable competition to address needs identified at the distribution level and we think there will be a good case for introducing competition to distribution networks in the future. We asked if the competition criteria set out in the consultation for projects (new, separable and high-value) were suitable for late-model competition at distribution network level.

Our decision: At distribution level, **we anticipate that we will use the new, separable, and high-value criteria for late-model competition.** However, we will consider further what the high-value threshold should be when we are closer to establishing competition at distribution level.

Nine: Views on the appointed body at distribution level

When rolling out competition to distribution level, we will need to consider who may be suitable to run tenders (the Appointed Body). We asked if there were bodies other than Ofgem which the Secretary of State might consider as the Appointed Body to run competitions at distribution level.

Our decision: At this time, there is not enough certainty about the future of distribution system governance to determine who we recommend as the Appointed Body for competition at distribution level. **We will give further consideration to the Appointed Body following the outcome of Ofgem's Distribution System Operator governance review⁶, and when we are closer to implementing legislative competition at distribution level.**

⁶ Ofgem *Call for Input: Future of local energy institutions and governance* (2022)
<https://www.ofgem.gov.uk/publications/call-input-future-local-energy-institutions-and-governance>

Decisions Made

Consultation Question	Decision
1	<p>Certain strategic projects which are likely to engage in the market between now and 2026 will, where it is in consumer interests, be exempt from the introduction of onshore network competition. Ofgem will publish a consultation that includes a list of projects that it considers should be exempt and will publish its final decision by the end of 2022.</p> <p>Competition will become the norm in due course. Individual projects will be considered for their eligibility for competition using criteria set by Secretary of State, and Ofgem will publish a decision on the type of competition model to be used on any given network need at the earliest suitable opportunity⁷:</p> <ul style="list-style-type: none"> • In the case of early-model competition, the network need would be assessed against the early-model criteria⁸ once the Electricity System Operator modelling identifies the network need (currently at the Network Options Assessment (NOA) signal. Ofgem has recently confirmed it is minded that this should be through the Centralised Strategic Network Plan in future⁹. • In the case of late-model competition, this will be, at the latest, by the point at which Ofgem makes its final approval of the proposed design, currently referred to as the Final Needs Case Assessment under LOTI in RIIO-2. <p>Ofgem will set the process for establishing eligibility for competition as part of agreeing the next transmission price control.</p>
2	<p>The factors that will be taken into account in assessment of bids in competition will be set out in the Invitation to Tender documentation and the Tender Regulations developed by Ofgem and the Appointed Body. We consider that these should be set in a solution-agnostic and location-agnostic way, and so these factors will need to be prioritised and weighted to suit the project at hand.</p>

⁷ See Government Analysis section for further details.

⁸ For more information on the criteria for early-model competition, see Ofgem *Early Competition Decision* (2022) pp.29-34 https://www.ofgem.gov.uk/sites/default/files/2022-03/Early_Compensation_Decision_Final.pdf

⁹ Ofgem, *Consultation on our minded-to decision and draft impact assessment on the initial findings of the Electricity Transmission Network Planning Review* (2022)

Competition in Onshore Electricity Networks

3	Ofgem will provide information on what licensing arrangements, if any, the winning bidder will be subject to, as part of setting the Tender Methodology.
4	When appointing a body (the “Appointed Body” ¹⁰) to run tenders for competition, we propose that the Secretary of State consider, inter alia, the factors, both essential and desirable, as set out in the consultation.
5&6	In exercising their power to appoint an Appointed Body, we propose that the Secretary of State appoint National Grid Electricity System Operator (NGESO) to the role of the Appointed Body for onshore competitions at transmission level, with a view that this function will eventually be transferred to a Future System Operator. The legislative framework will need to ensure that the Appointed Body will work closely with Ofgem, who will oversee the competitive process. This is not a final decision and will be subject to the Secretary of State’s discretion at the time of the appointment.
7	We consider that a high-value threshold of £100m is the correct point for the competition criteria, in the context of late-model competition at transmission level. We will keep this under review as the competitive market becomes more established.
8	At distribution level, we anticipate that we will use the new, separable, and high-value criteria for late-model competition. However, we will consider further what the high-value threshold should be when we are closer to establishing competition at distribution level.
9	At this time, there is not enough certainty about the future of distribution system governance to determine who we recommend as the Appointed Body for competition at distribution level. We will give further consideration to the Appointed Body following the outcome of Ofgem’s Distribution System Operator governance review ¹¹ , and when we are closer to implementing legislative competition at distribution level.

¹⁰ This consultation response refers to an “Appointed Body” because this is the language that was used during the consultation and in responses from stakeholders. The Energy Security Bill refers to the designation of a “delivery body”. For all intents and purposes, the “Appointed Body” and “Delivery Body” are the same entity, and any reference in this document to “Appointed Body” can be read as the same as “Delivery Body” in the Schedule 12 of the Energy Security Bill.

¹¹ Ofgem *Call for Input: Future of local energy institutions and governance* (2022)

<https://www.ofgem.gov.uk/publications/call-input-future-local-energy-institutions-and-governance>

Question 1: When to determine the type of competition to be utilised, if any

We asked:

In order to provide certainty for those planning networks and potential bidders, we think it would be appropriate for Ofgem to publish a decision on the type of competition, if any, to be utilised on any given constraint as part of the needs case assessment. Do you agree this is appropriate?

Our Decision:

Government set out in the British Energy Security Strategy (BESS)¹² that certain infrastructure will be exempt from the introduction of onshore competition, to ensure that the period of transition to competitive processes for network delivery does not slow down our progress towards energy security and decarbonisation objectives. In this response, we set out further information on how the exemption announced in the BESS will work in practice. **Certain strategic projects which are likely to engage in the market between now and 2026 will, where it is in consumer interests, be exempt from the introduction of onshore network competition.** This will help reduce the impacts of uncertainty about when competition will be in force and reduce the likelihood of adversely impacting delivery timelines for strategic projects that are key to delivering on targets such as our 2030 offshore wind target, during the period while competition is implemented. **Ofgem will publish a consultation that includes a list of projects that it considers should be exempt and will publish its final decision by the end of 2022.**

Other than in respect of initial exempted projects, we expect competition to become the norm and to be incorporated into network companies' project plans from the outset so the need for exempting strategic projects will no longer apply. Individual projects will be considered for their eligibility for competition using criteria set by the Secretary of State, and Ofgem will publish a decision on the type of competition model to be used on any given network need at the earliest suitable opportunity¹³:

- In the case of early-model competition, the network need would be assessed against the early-model criteria¹⁴ once the Electricity System Operator modelling identifies the network need (currently at the Network Options Assessment (NOA) signal. Ofgem has recently confirmed it is minded that this should be through the Centralised Strategic Network Plan in future¹⁵.
- In the case of late-model competition, this will be, at the latest, by the point at which Ofgem makes its final approval of the proposed design, currently referred to as the Final Needs Case Assessment under LOTI in RIIO-2.

¹² BEIS *British Energy Security Strategy* (2022) <https://www.gov.uk/government/publications/british-energy-security-strategy>

¹³ See Government Analysis section for further details.

¹⁴ For more information on the criteria for early-model competition, see Ofgem *Early Competition Decision* (2022) pp.29-34 https://www.ofgem.gov.uk/sites/default/files/2022-03/Early_Competition_Decision_Final.pdf

¹⁵ Ofgem, *Consultation on our minded-to decision and draft impact assessment on the initial findings of the Electricity Transmission Network Planning Review* (2022)

Competition in Onshore Electricity Networks

Ofgem will set the process for establishing eligibility for competition as part of agreeing the next transmission price control.

What respondents said:

Nearly all respondents agreed that it will be appropriate for Ofgem to publish a decision on the competition model, if any, to be utilised on any given network need.

Some respondents said that they expect Ofgem to consult on their minded to position, prior to reaching a decision.

A couple of respondents suggested that Ofgem should also provide a level of oversight/ input in the identification of need on the network that may be appropriate for competition, ahead of deciding on whether it should be competed and the model of competition. They wanted to know how Ofgem will assess the needs case and starting assumptions. They want to know whether Ofgem will be able to challenge information supplied about the network need and whether there would be obligations placed on the system operator or network companies to report network needs within a specified timeframe (with enforcement behind it). They suggest that this approach will minimise the risk of a network need becoming overly complicated and only possible to address by late-model competition.

A couple of developers responded disagreeing with the approach altogether. They suggest that a generation developer should submit an application for capacity to the Appointed Body with a request for a particular connection and then bidders would participate in the tender, to offer a grid connection that meets the needs of the applicant. They say the proposed approach is challenging as only the incumbent network companies have full awareness of their own networks and therefore developers would want details of the network's need to be shared with bidders.

A lot of respondents also shared their views on when a decision should be taken and models of competition.

Models

Most respondents expressed a strong preference for early-model competition over late-model competition, with some respondents suggesting that late-model competition should not be used at all, especially in cases where the project is required to meet specific net zero targets.

- **Early-Model Competition**

Respondents said that early competition is more likely to drive benefits for consumers. For example, one respondent said that the greatest value to consumers can be achieved through an early-model of competition, which can unlock innovation within traditional as well as non-traditional solutions. Innovation can be achieved during the design and preliminary work stages of traditional solutions, as well as during construction and operation. Early competition also provides clear accountability for one party throughout the life of the project.

Competition in Onshore Electricity Networks

- Late-Model Competition

One respondent argued that late-model competition introduces issues with accountability for communities and wider stakeholders when the network solution, developed and consented by incumbent TOs in consultation with stakeholders, is then delivered by a separate entity. The respondent argued that competition raises questions about commitments and liabilities agreed upon during the development phase and introduces fragmentation of responsibility and accountability.

- Mixed Approaches

One respondent said that they do not support the introduction of mixed approaches e.g. early competition models in some cases but late (or very late) competition models in others. They believe multiple processes adds unnecessary complexity and potential confusion to the process for all parties. They said that the decision should be limited to 'no competition' and 'competition', where competition refers to only one type. In addition, there should be a clear standardised framework of what constitutes 'no competition' alongside the criteria for 'competition' and that there should be a no 'competition unless otherwise proven' principle.

Timing

Nearly all parties note that the earliest possible notice of a decision to compete and the model of competition selected will be key to success. Nearly all respondents said that this notice needs to come with as much information as possible, including on the Tender Methodology and the types of risks bidders are expected to take on.

- Uncertainty and long-lead times for supply chain

Some respondents cautioned on the risks that introducing uncertainty may cause, particularly from late-model competition. They highlighted that long lead times for supply chain and procurement could be exacerbated, with network companies suggesting that these infrastructure projects typically take circa 10 years to be delivered once the party responsible for delivery is confirmed. One respondent observed that the UK is operating in an increasingly globally constrained supply chain, particularly for High Voltage Direct Current (HVDC) and thus there is a clear need to provide supply chain certainty at the earliest possible opportunity. Respondents say that uncertainty on the delivery vehicle prevents wider consumer benefits which come from supply chain certainty and could risk the delivery timelines associated with this already challenging planning and construction need. Several respondents therefore put forward that the earliest notice possible should help to mitigate this risk.

- Initial/ Final Needs Case assessment and Network Options Assessment (NOA) 'Hold' Signals

Based on this challenge, several respondents strongly suggested that the decision on when to determine the model of competition to be used, if any, should be made as early as possible. Rather than the Final Needs Case being the latest point at which late-model competition is applied, some respondents felt that a decision should always be made at the earlier Initial Needs Case stage of assessment. This assessment stage comes ahead of any planning approval being sought but once the design of the project is unlikely to change. They consider

Competition in Onshore Electricity Networks

this would enable maximum use of early-model competition and should help increase the amount of information available for forward planning. The respondents also suggested that this should help to provide certainty to the market and help the long-lead times to be met, for businesses lining up their supply chains.

National Grid Electricity System Operator recommended in its response, that the early-model competition process may need to begin where projects currently receive a Networks Options Assessment (NOA) 'hold' signal, to provide sufficient time for the pre-tender and tender process to complete before significant constraint costs are incurred. This is earlier than when a needs assessment would currently take place.

Other respondents, whilst valuing early certainty, did not raise concerns over timing or with this decision being taken by the Final Needs Case assessment. For example, one respondent welcomed competition to speed up the pathway to net zero. Their view is that without competition, they would be concerned that the pace of change in the electricity system will be too slow and will be dominated by asset-based solutions.

- Ruling out projects to meet net zero targets

Some respondents recommended that in the interests of certainty, and on the basis that legislation will be required to enable competition, certain projects that are already in the pipeline to deliver for the UK's legally binding net zero targets should be ruled out. For example, we received suggestions that all projects required to connect the 40GW of offshore wind by 2030 should be removed from scope, and/or projects which form part of RIIO-2¹⁶ should be excluded.

Government's analysis:

When competition will apply to projects

Electricity networks are key enablers for net zero and energy security. Networks ensure new low-carbon and renewable generation can reach demand centres and that there is sufficient capacity on the network to connect low-carbon technologies, like electric vehicles and electric heat pumps. Competitive pressure in electricity networks is expected to improve efficiency, saving consumers money, and encourage further innovations in system design and operation. Government recognises that it is important that the introduction of competition assists in the accelerated delivery of networks and does not cause delay to strategic network projects on the critical path for meeting our targets for achieving net zero and accelerating domestic supplies of clean, affordable electricity. We therefore consider it essential to provide as much certainty to industry as possible as to which projects will be eligible for competition, whilst ensuring that we (a) are on track to deliver on HMG's objectives for net zero and energy security and that we (b) maximise the potential benefits from enabling competition. With this backdrop, Government announced in the British Energy Security Strategy that 'certain infrastructure identified in

¹⁶ These are not the only projects that were suggested as possibly suitable for exclusion. Respondents also highlighted other relevant targets, namely the UK Government's 78% emission reduction target by 2035 and the Prime Minister's recently announced plans for a fully decarbonised power grid by 2035 and Scottish Government's 11GW capacity by 2030.

Competition in Onshore Electricity Networks

the Holistic Network Design and Centralised Strategic Network Plan will be exempt from the introduction of onshore network competition'. We elaborate in the sections below what this will mean both in the near and long term.

Exemptions for Strategic Projects during a transitional period

Significant onshore transmission network reinforcements are required to meet Government's ambitions for net zero, including connecting up to 50GW of offshore wind to the GB network by 2030¹⁷. Further information on what connection and reinforcement infrastructure is needed was set out in the Holistic Network Design (HND) delivered as part of the Offshore Transmission Network Review (OTNR) in July 2022. Further detail is included in the Network Options Assessment 2021/22 Refresh. Ofgem recently confirmed a new strategic model for network planning. Once it is established, the FSO will deliver Centralised Strategic Plans (CSNPs) at appropriate intervals (expected to be every 2-3 years as an initial estimate).

These planning mechanisms will provide investment signals to the TOs as well as identifying strategic investments that might be suitable for competition. Due to the strategic significance of these projects, we consider it necessary to establish a method of exempting certain projects from competition, during the period when competition is still being established and before it is fully embedded into the business planning process. This is in recognition of the need to avoid potential delays to near-term critical reinforcement projects and to maximise the benefits associated with coordinated infrastructure planning. Furthermore, this is during a period when legislation still needs to be taken through Parliament and the necessary technical regulations (such as the Tender Methodology) put in place for competition to become the norm in business planning processes.

We expect this "transitional period" to apply only to certain strategic projects which are likely to engage in the market between now and 2026. As set out above, we introduced into Parliament the Energy Security Bill in July 2022, which includes a legislative measure to enable competition in onshore networks. Based on the assumptive timelines set out in the consultation in August, the earliest competitions could commence under it would be in 2024. To exclude those strategic projects ready to engage the market up to 2026 allows parties with projects due to tender after that sufficient planning time to include competition in their project timescales.

During this transitional period, Ofgem will assess whether these strategic projects, with invitation to tender dates that are anticipated before 2026, should be excluded from onshore competition. Ofgem will publish a consultation that includes a list of projects that it considers should be exempt and will publish its final decision by the end of 2022. They will then consider if further projects should be exempted from competition on a rolling basis from that point, to allow for developments and changes to network needs going forward. Towards the end of the transitional period, Ofgem will confirm at which point in 2026 it will end¹⁸.

¹⁷ BEIS *British Energy Security Strategy* (2022) <https://www.gov.uk/government/publications/british-energy-security-strategy>

¹⁸ Additional projects may be identified as being needed by 2026 after this 2022 date and will be considered by Ofgem in later publications exempting other projects from competition.

Competition in Onshore Electricity Networks

Government will support Ofgem as they consider whether additional incentives and obligations should be placed on network companies whose projects are exempt to ensure that these projects are delivered in a timely manner to ensure delivery for net zero and the ambition identified in the British Energy Security Strategy.

Looking beyond exemptions for strategically significant projects, identified in the HND and NOA (and in the future by the CSNP when it is established), there may be additional large electricity transmission projects that are ‘in flight’ when competition legislation comes into effect, but not captured in the HND and NOA assessment process set out above. Government is also confirming its view set out in the consultation that these ‘in flight’ projects ‘will not be subject to competition. By ‘in flight’ we mean projects where incumbent network operators have commenced negotiations with suppliers and contractors following confirmation via an Initial Needs Case or Final Needs Case decision from Ofgem that the progression of the project to construction is in the interest of consumers.

Eligibility for competition once established:

For projects which are not exempted from competition during the transitional period, we agree with respondents that Ofgem should make their decision on whether to compete, and the model selected, at the earliest possible point.

Ofgem’s decision on whether the project should be competed will be based on a network need meeting criteria on projects eligible for competition set by the Secretary of State in legislation. Ofgem will consider the application of these criteria, and the process for doing so will be set through the next transmission price control, due to start in April 2026.

Under the early competition model, the network need would be assessed against the early-model criteria¹⁹ once the Electricity System Operator modelling identifies the network need (currently at the Network Options Assessment (NOA) signal, although we expect this will be through the Centralised Strategic Network Plan in the future). This point comes ahead of the incumbent Transmission Owner (TO) taking forward the detailed design and planning consent process for the project, so this stage will occur before the equivalent Initial Needs Case or Final Needs Case currently occur under the Large Onshore Transmission Investment reopener process. The Appointed Body will then consider the network need and make a recommendation to Ofgem on whether to start the tender. The network needs that do not meet the early-model criteria will be progressed in line with the prevailing regulatory arrangements in place at the next price control period, which starts on 1 April 2026.

Ofgem will publish a decision on whether a project will be competed under late-model competition²⁰ at the earliest suitable opportunity, and at the latest, by the point at which Ofgem makes its final approval of the proposed design, currently referred to as the Final Needs Case Assessment under LOTI in RIIO-2. This will be based on the late-model competition criteria.

¹⁹ For more information on the criteria for early-model competition, see Ofgem *Early Competition Decision* (2022) pp.29-34 https://www.ofgem.gov.uk/sites/default/files/2022-03/Early_Competition_Decision_Final.pdf

²⁰ For more information on models of competition, see Ofgem *Decision – RIIO-2 Final Determinations – Core Document (REVISED)* Chapter 9 https://www.ofgem.gov.uk/sites/default/files/docs/2021/02/final_determinations_-_core_document_revised.pdf

Competition in Onshore Electricity Networks

For more detail on the late-model competition criteria, see our response to Question 7. Nearly all respondents said that this decision on whether to compete and the model to be used needs to come with as much information as possible, including on the assessment criteria and the types of risks bidders are expected to take on. We will work with Ofgem and the Appointed Body to ensure this happens.

Benefits of different models of competition

We note that there was a preference from nearly all respondents on the use of early-model competition over the use of late-model competition. Early-model competition maximises opportunities for innovation and introducing third parties to the market, and we support these as core goals of a new competitive framework. Early-model competition also creates significant opportunity for driving efficiency and ensuring that benefits of competition are felt by end-consumers. Therefore, we intend to enable a legislative regime where early-model competition should be used where it meets certain criteria including where it is appropriate for the project and cost-effective for the consumer.

Late-model competition on the other hand is likely to be more appropriate to apply to certain network needs; for example, those where the type of solution is already known and there are shorter timescales for delivery. As set out in the accompanying Impact Assessment²¹, we anticipate that late-model competition will bring up to £1bn in savings on projects tendered on the transmission system over the next ten years.

We expect that the strategic network planning arrangements proposed by Ofgem as part of its Electricity Transmission Network Planning Review²², in combination with any specific additional project identification processes developed for competition models, should allow Ofgem sufficient oversight of constraints when making an assessment on whether to use competition and the type of competition to apply.

²¹ BEIS *Competition in Onshore Electricity Networks Impact Assessment* (2021)

<https://www.gov.uk/government/consultations/competition-in-onshore-electricity-networks>

²² Ofgem *Consultation on the initial findings of our Electricity Transmission Network Planning Review* (2022)

<https://www.ofgem.gov.uk/publications/consultation-initial-findings-our-electricity-transmission-network-planning-review>

Question 2: Key factors when assessing bids

We asked:

In order to enable fair consideration of flexible and traditional solutions under a competitive framework set out in legislation, what are the key factors you consider should form part of the Appointed Body's assessment of bids in the tender process?

Our Decision:

The factors that will be taken into account in assessment of bids in competition will be set out in the Invitation to Tender documentation and the Tender Regulations developed by Ofgem and the Appointed Body. We consider that these should be set in a solution-agnostic and location-agnostic way, and so these factors will need to be prioritised and weighted to suit the project at hand.

We consider assessment of bids should include evaluation and consideration of:

- Whole life costs (OPEX, CAPEX and financing costs) of the project, from development to decommissioning and next steps for the system after the solution finishes its revenue period.
- Factors relating to the bidder: financeability, experience of timely delivery of projects, experience of management of contractors (where relevant), experience of delivering for net zero, including a bidder's sustainability and environmental experience, experience of stakeholder management, including engagement with the public and public bodies.
- Factors relating to the solution tendered: suitability of solution to solve network need, deliverability of solution in a timely fashion and adhering to industry standards, financeability of solution, long-term costs and benefits of the solution to consumers, communities and the wider network, adaptability of solution to meet future needs of network as it changes, impact on resilience and security of supply.

What respondents said:

Most respondents, from a range of backgrounds, including investors, network companies and developers, provided a response to this question.

Several stakeholders emphasised the importance of ensuring the problem statement (i.e. the nature of the network need) and assessment criteria to be applied during the competitive process should be transparent and made clear ahead of any tender being launched, to allow predictability and certainty. This will allow bidders to be clear in their bids and submit a solution they consider most appropriate to the solution, knowing the scope of the Tender Regulations and Tender Documentation. One respondent suggested Tender Regulations and Tender Documentation should be drafted with stakeholder input.

In addition, a few stakeholders emphasised that Government and Ofgem should be solution-agnostic and location-agnostic in setting assessment criteria, and so certain assessment criteria should have different weightings to allow for this. For example, finance criteria could

Competition in Onshore Electricity Networks

have greater weighting than technological criteria to allow for a greater range of innovators to come forward in these competitions.

The majority of respondents to this question aligned in their view that key factors to any assessment criteria for bids should include:

- Whole life costs (OPEX and CAPEX) of the project, from development to decommissioning and next steps for the system after the solution finishes its revenue period.
- Risk factor of the solution solving the network need and the bidder in managing the solution.
- Financeability of bidder and solution proffered.
- Experience of bidder in
 - Timely delivery of projects
 - Management of contractors
 - Sustainability and environmental considerations, focusing on net zero
 - Local stakeholder engagement and providing community benefits
 - Engaging with the regulator and public entities
- Deliverability of the solution proffered, in terms of meeting industry standards and delivery in a timely fashion to solve the network need
- Long term benefit of the solution to consumers and to the grid more widely
- Impact of solution and suitability of bidder for maintaining security of supply and resilience.
 - This includes the solution allowing the high reliability standards, integration, and performance of GB's transmission networks to be maintained.
 - Some respondents argued that new entrants must be subject to the same rules, responsibilities, and accountabilities as incumbent network companies, including being able to demonstrate that they have robust financial backing.
- Flexibility of the solution to adapt to changes on the network in future, taking account of the fact the network is a fast-paced changing one.

One stakeholder suggested costs beyond the solution should be considered, like Final Consumption Levies.

National Grid ESO restated their preference for early-model competition to involve two Invitation to Tender rounds, where the focus is on the solution proffered (for example, whether network need is met, risks to network reliability, deliverability and environmental and social impacts) in the first round, and commercial considerations are considered in the second round when a narrower group of bidders are competing.

Government's analysis:

Competition in Onshore Electricity Networks

As set out in our consultation, opening up electricity network ownership and operation to third parties will allow for new, innovative parties, with access to different sources of capital, to invest in network infrastructure. It creates a new market, bringing with it potential for new, green jobs across all of Great Britain, while economies of scale and competitive forces should drive efficiency and lower costs for consumers.

To achieve these benefits, the widest range of solutions possible should be able to bid into any tender to solve a network need and be considered in an equitable manner to achieve the best outcome for the grid and for consumers. Therefore, we agree with respondents that any Tender Methodology used to compare different bids in a network competition should be solution-agnostic and location-agnostic, and that matters for consideration in the competition could be weighted to allow for such neutral and fair consideration of bids.

We recognise the importance of being upfront and transparent in the development and setting of factors for consideration of bids. Bidders will be made aware of the nature of the network need to be informed so as to tailor their bid and solution proffered to be most appropriate as they see fit. It is anticipated that the Appointed Body will detail the assessment criteria in the Tender Documentation, and that this will be available to potential bidders with an appropriate amount of time to enable bidders to ready their bids for submission by any set deadline. We will work closely with Ofgem to ensure these principles help guide the detailed documents and that relevant factors are taken into account by the Appointed Body to consider when assessing tenders.

We agree with the key principle put forward by respondents that ensuring security of supply as well as consumer value for money should be considered in assessment criteria. This could be that assessment criteria include both the nature and experience of the bidder itself as well as the nature and tested viability of the solution proffered.

We consider that the detailed factors for consideration will likely vary according to the nature of the network need in question and will be a matter for the Appointed Body and Ofgem as tender documentation and Tender Regulations are set. We agree with respondents that these documents should be clear, upfront and available ahead of any competition to allow potential bidders time to prepare their bids. We agree that factors set out in the Response Summary above put forward by respondents should be considered as guiding principles for detailed assessment criteria to be set by the Appointed Body and Ofgem in the Tender Regulations and wider Tender Documentation.

Question 3: Market Barriers, types of solutions, types of bidders

We asked:

Are there any market barriers to smart, flexible solutions being competed alongside traditional solutions in a fair and open competitive process? It would be useful to understand the types of bidders interested in such competitions, and the types of solutions they might put forward for consideration.

Our Decision:

We welcome the interest in participating in competitions from a range of respondents, and the generally held view that traditional wire solutions and smart, flexible solutions, can and should compete against one another. Ofgem will provide information on what licensing arrangements, if any, the winning bidder will be subject to, as part of setting the Tender Methodology.

What respondents said:

Most respondents did not define their comments in relation to whether they were discussing market barriers, bidders or solutions. However, we categorised responses into these three categories for the purpose of this response. We recognise that some of these comments fit across multiple categories.

Market Barriers

Many respondents felt that there are no market barriers (at least in principle) to smart solutions competing alongside traditional wire solutions. However, other respondents did see market barriers. These potential barriers are listed under the seven bullet points below.

- Certainty on timing, delivery, and supply chains

One respondent highlighted that taking a project-by-project approach to tendering is unlikely to provide sufficient certainty for developers and their associated supply chains to make the timely investment decisions in their capacity and capability. Other respondents highlighted that lack of certainty then exacerbates issues with timescales for delivery of net zero.

- Comparing smart/flexible with traditional and assessment of bids

Whilst a respondent noted, and others made similar comments, that “any developer” would be very excited by the opportunity to propose and develop smart solutions, including a mix of smart flexible and traditional, several respondents expressed concern about how solutions are compared and how this may impact on the assessment of bids, especially if there is no Cost Benefit Assessment (CBA) to assess this.

Respondents suggested that there is a need for Ofgem and BEIS to determine how these respective benefits should be fairly measured and a plan put in place so that marginal cases do not cause delays.

Competition in Onshore Electricity Networks

One respondent noted favourably how the Early Competition Plan by National Grid ESO proposes bundling bids together to help give flexibility solutions a better chance of being selected.

A couple of respondents expressed concern about the Appointed Body and its possible familiarity with traditional over flexible solutions and the probability of this leading to perceived or actual bias when assessing bids.

Another respondent suggested that some solutions may not meet Security and Quality of Supply Standard (SQSS) and planning standards and suggested this should be accounted for in the Invitation to Tender.

- Planning regime in Scotland, particularly s.36 planning application

One investor commented that the current planning regime in Scotland is an additional barrier to the deployment of storage. Building a 50MW battery requires a section 36 planning application, which must be approved by government. This rule recently changed in England and Wales: now, local authorities can give consent for battery storage construction, reducing the complexity of the planning application process. A respondent suggested that it would be useful if this reform could be introduced in Scotland, where there is a significant system need for new grid-scale batteries to alleviate network needs.

A respondent added that local authorities may not be familiar with new technologies such as batteries, and therefore that there needs to be a new, bespoke planning regime to help bring forward the deployment of new flexibility capacity and to ensure that there are no delays to delivery.

- Absence of guidance on Distribution System Operation (DSO) delivering flexibility in RIIO ED2

A couple of respondents said that a fundamental barrier to smart flexible solutions is the absence of guidance on the DSO framework. They noted that, whilst there is real value in DNOs delivering smart, flexible solutions through their DSO role, Ofgem have yet to consult on what this framework looks like.

- Issues with network charging

One respondent commented that the current Transmission Network Use of System (TNUoS) regime is impeding the development of a smart, flexible, zero carbon grid by disincentivising investment in storage.

- Constraint on connection availability for flexible solutions as large-scale connections prioritised by incumbents

One respondent commented that integrating flexible solutions into the electricity grid has proven problematic in their experience. They found that smaller scale innovative solutions are unable to obtain a connection, even if they are offering a storage solution as part of their connection, due to larger-scale projects being prioritised by incumbent transmission network owners.

Competition in Onshore Electricity Networks

- Licensing and Unbundling

One respondent expressed concern that rules on unbundling mean that a combination of smart and traditional (which could be the most efficient option) could not be put forward by TOs.

However, another respondent sees it as important to ensure that opening onshore networks to competition does not, in the longer term, lead to an erosion of the strict unbundling rules preventing network companies from participating in the provision of competitive services.

Two more respondents felt that there was a lack of clarity on licensing arrangements.

Types of Bidders:

One respondent commented they were concerned that there is little to no evidence of appetite from third parties to compete. However, several developers, investors and an independent Distribution Network Operator (iDNO) all expressly stated their support and interest in participating. One respondent further flagged interest from international developers with experience in global transmission markets.

One respondent commented that some new market players may find it challenging to navigate through technical and regulatory arrangements but that this could be addressed by clear guidance throughout the tender process. Another respondent highlighted Ofgem may need to provide clarity on what, if any, licensing arrangements bidders will be subject to.

Types of Solutions

Most respondents engaged with this element of Question 3. Comments on types of solutions have been themed into the three bullet points listed below.

- Asset Replacement Work

Several network companies responded stating that they do not support the application of competition to asset replacement work.

One respondent with this view suggested that applying competition to asset replacement work results in a suboptimal solution for consumers, with increased cost, complexity, and risk to safety and reliability of the system. They also think there is limited scope for innovation in terms of asset replacement, and so there is limited benefit from competition for replacing these assets.

Another respondent highlighted that asset replacement work requires a wide array of considerations, not only to replace assets, but to improve network resilience and reduce network risks. If asset replacement work is opened to competition, it would restrict the ability of asset owners to take all these considerations into account to deliver the most efficient, safe, and reliable asset health management for consumers.

Another respondent expressed their concern that introducing multiple layers of ownership and control would lead to confused accountabilities in the event of system issues or even complex day to day routines such as switching, increasing risk to consumers. There are also multiple

Competition in Onshore Electricity Networks

practical issues – such as access to third party owned assets and land easements, etc. which they believe are legally complex to resolve.

- Financing of smart solutions

Two respondents commented that traditional financing solutions may not be available to smart flexible solutions or will come at a significant premium, due to financial institutions concerns regarding projects utilising unproven technologies.

Another respondent warned of the importance of ensuring competition does not undermine existing flexible competition for distribution and the incentives within RIIO that work well.

- Distinction between early-model and late-model competition

One respondent commented on their concern about how flexible and traditional solutions competing against one another will work for late-model competition, highlighting existing rules on ownership, planning consents, land access and network connections will mean that certain solutions are unduly precluded from participating, and consequently late-model competitions will feature network-based, traditional solutions²³.

Government's analysis:

Market Barriers

We are pleased to note that most respondents did not feel there were market barriers to smart solutions competing against traditional wire solutions.

- Certainty on timing, delivery, and supply chains

Concerns around certainty of timing, delivery and supply chains, are covered in the analysis of Question 1 above.

- Comparing smart/flexible with traditional and assessment of bids

We are pleased by the level of interest from respondents on developing smart solutions and the opportunity to compete with a mix of solution types.

Where respondents suggested that there is a need for Ofgem and BEIS to determine how the respective benefits of different types of solutions should be measured, we refer to our response to Question 2 above, on how bids will be assessed.

We refer to our response to Questions 5&6 below on upskilling the Appointed Body and dealing with bias.

- Planning regime in Scotland, particularly section 36 planning application

²³ As noted in the analysis below, late-model competition is competition that occurs after the main design phase is complete and major planning consents are secured, so it is the construction and delivery of a project that are tendered for rather than the high-level solution design (which is the main distinction from early-model competition). Therefore, we consider that this concern is based on a misunderstanding of the models of competition.

Competition in Onshore Electricity Networks

In relation to the comment about the planning regime in Scotland and particularly s.36 planning application, we expect that bidders should be taking into account practicalities such as securing planning consent as part of their bid. Planning is a devolved matter, and so planning requirements for network build will vary by jurisdiction. We will continue to engage closely with the Scottish Government to understand the differences and align where appropriate.

- Absence of guidance on Distribution System Operator (DSO) delivering smart and flexibility solutions in the price control, RII0 ED2.

We do not agree that an updated DSO delivery framework is required to be in place in order for smart solutions to be compared against traditional ones. DNOs are already required to carry out a Cost Benefit Analysis (CBA) justifying interventions and investment decisions, including those regarding smart and flexible solutions. However, as discussed further in our response to Questions 8 and 9, we intend to begin the delivery of competition policy on the transmission network in the first instance, before focusing on distribution. Therefore, there is a likelihood that more will be known about the future of DSO by the time we are ready to further develop competition policy at the distribution level. The outcome of Ofgem's DSO governance review may help to shape this further.

- Issues with charging

We note the view that the current Transmission Network Use of System (TNUoS) charging regime is impeding the development of a smart, flexible, zero carbon grid by disincentivising investment in storage. Ofgem outlined next steps following its Call for Evidence on transmission charging reform²⁴. We will continue to work with Ofgem as improvements to transmission charging are progressed, working to ensure a level playing field for all network solutions that reflects costs placed upon the system by users in a fair way.

- Constraint on connection availability for flexible solutions as large-scale connections prioritised by incumbents.

This is covered in our response to Question 4 below.

- Licensing and Unbundling

We believe that the rules on unbundling encourage greater diversity in market participants and thus also help to drive innovation. It is possible for multiple parties to create a consortium and bid in with a solution that does combine different smart and traditional elements, if the ownership remains separate and the rules on unbundling are followed.

Types of Bidders

In our consultation, we commented that it would be useful to understand the types of bidders that would be interested in participating in competitions. Responses to our consultation were clear that there is interest from third parties to compete.

²⁴ Ofgem *Transmission Network Use of System Charges – A Task Force Update* (2022)
<https://www.ofgem.gov.uk/publications/tnuos-task-forces>

Competition in Onshore Electricity Networks

We welcome the interest from a wide variety of respondents in taking part in competitions in the future.

One respondent noted that new market players may find it challenging to navigate through technical and regulatory arrangements. We recognise that experience with technical regulations is one of the advantages that incumbent network companies bring to the development and maintenance of GB electricity networks. However, this type of experience may also be something that new third parties can bring from projects they own and operate elsewhere in the world. We also believe that this potential difficulty for new parties will reduce with time, as the market becomes more established, and they gain experience of GB electricity regulation. For example, since Offshore Transmission Owner (OFTO) competition was introduced, third parties exclusively have won competitions so far to date. The Tender Regulations will be set by Ofgem, with input from the Appointed Body (as set out in response to Question 2). Ofgem will provide information on what licensing arrangements, if any, the winning bidder will be subject to, as part of setting the Tender Methodology.

Types of Solutions

- Asset Replacement Work

We note that several network companies do not support the application of competition to asset replacement work. We support the use of competition on projects that will meet the criteria for competition. As set out in our consultation, our proposals relate to projects which are new, including projects that involve a *complete* replacement of existing assets. This does not include support for the use of competition for partial replacement or repair of existing assets, as this would risk unfairly interfering with existing rights of incumbent network companies. Where the network need requires a new solution (and the need also meets the other competition criteria), then it is right that companies have the ability to bid into a competition with their proposed solutions.

- Financing of smart solutions

We note the concern that traditional financing solutions may not be available to smart, flexible solutions or will come at a significant premium, due to financial institutions' concerns regarding projects utilising unproven technologies.

It is a well-recognised concept that investors will balance the level of risk they are prepared to take in an investment, against the level of return it will offer. The market for smart and flexible technologies, and for innovative solutions more broadly is an active one with much investor activity. For example, Piclo operates Piclo Flex, an independent marketplace facilitating local, Distribution System Operator (DSO) flexibility markets²⁵. Piclo Exchange (their online

²⁵ BEIS *Smart Systems and Flexibility Plan* (2021)

<https://www.gov.uk/government/publications/transitioning-to-a-net-zero-energy-system-smart-systems-and-flexibility-plan-2021> and <https://www.gov.uk/government/publications/flexibility-exchange-demonstration-competition-flex-winning-projects/flex-competition-winning-project>.

Piclo *Case Study* (2020) https://uploads-ssl.webflow.com/6123718de4b96c44035b9af8/61e6c519f623fb46a117aad5_Piclo%20Case%20Study%20-%20UKPN%20-%20July%202020%20-%20Release.pdf

Competition in Onshore Electricity Networks

marketplace) connects energy flexibility companies in one marketplace to list, buy and sell contracts with each other. To date, £47 million in flexibility contracts have been awarded via Pico. This example demonstrates that bringing new third parties into a new marketplace (as will also be the case through onshore competition) that includes new and innovative technologies is of interest to investors.

We also received several responses to this consultation which were from investors expressing their interest in being able to take part in a new competitive market, emphasising the opportunities that competing smart and flexible solutions with traditional network build could bring.

The longer a market is established, the less risk that is associated with it, making it in many respects even easier to attract investment for. Therefore we are of the view that with time, competitions which include smart and innovative technologies will help rather than exacerbate any difficulties with financing smart, innovative solutions.

- Distinction between early-model and late-model competition

We are not concerned about the comparison of different solution types once late-model competition has been identified as the appropriate delivery vehicle for addressing the network need. This is because late-model competition is competition that occurs after the main design phase is complete and major planning consents are secured, so it is the construction and delivery of a project that are tendered for rather than the high-level solution design (which is the main distinction from early-model competition).

Question 4: Appointing a Body to run tenders

We asked:

Do you agree that these are the right factors and indicators to be included in their consideration? (Factors summarised below²⁶)

Our Decision:

When appointing a body (the Appointed Body²⁷) to run tenders for competition, we propose that the Secretary of State consider, among other things, the factors, both essential and desirable, as set out in the consultation.

What respondents said:

Most respondents agree that the essential and desirable factors set out in the consultation are the right factors for the Secretary of State to consider when appointing a body (the Appointed Body) to run tenders for competitions on the electricity network. In summary these factors are consideration of:

- Independence, actual/ perceived bias and conflicts of interest
- Economies of Scale
- Technical Proficiency
- Experience in Running Tenders
- Other relevant considerations, e.g., national security risks

Some respondents suggested additional factors should be considered by the Secretary of State. These additional factors can broadly be grouped into three areas, which are expanded on below.

Some respondents also offered comments on how these factors may need to differ slightly if the Secretary of State appoints a body to run competitions in the distribution sector. These comments are also expanded on below.

There were some different views about the use of one of the essential factors and this is expanded on below.

Additional Factor 1 – Commercial and delivery experience/ skills base

²⁶ For more detail on these factors and their significance to the Secretary of State's decision, see pages 21-25 of BEIS *Competition in Onshore Electricity Networks Consultation* (2021)

<https://www.gov.uk/government/consultations/competition-in-onshore-electricity-networks>

²⁷ This consultation response refers to an "Appointed Body" because this is the language that was used during the consultation and in responses from stakeholders. The Energy Security Bill refers to the designation of a "delivery body". For all intents and purposes, the "Appointed Body" and "Delivery Body" are the same entity, and any reference in this document to "Appointed Body" can be read as the same as "Delivery Body" in the Schedule 12 of the Energy Security Bill.

Competition in Onshore Electricity Networks

Some respondents highlighted that building up a skills base when there are currently industry wide shortages is a challenge that takes time to address and should not be underestimated. This building up of a skills base, which includes experience in risk management, contracting and planning, ought to be factored into any Cost Benefit Analysis (CBA) when the Secretary of State is considering economies of scale and technical proficiency.

Some respondents emphasised that the Appointed Body needs to be able to assess the societal and environmental acceptability of solutions, as well as its deliverability. This ability ought to be factored into their appointment.

One respondent also emphasised that open-mindedness of the Appointed Body should be considered. The Secretary of State should ask themselves, is the body able to consider, without bias, flexible solutions alongside more traditional network solutions. To answer this in the affirmative, it is suggested the Appointed Body needs to have expertise in these types of solutions.

Additional Factor 2 – Governance Arrangements, including industry codes and standards

Some respondents requested that the Secretary of State considers how the Appointed Body is governed, particularly in relation to its accountability to current and future consumers, and whether it is expected to follow and prioritise industry codes and standards. This is to ensure that its decisions do not jeopardise the development of an economic and efficient system, and to ensure that security of supply is not compromised. Respondents also emphasised that decisions of the Appointed Body must not consequently cause network operators to have difficulty in meeting these standards and carrying out their obligations.

Additional Factor 3 – Authority to manage wider system impacts, including prioritisation of connection requests

Some respondents suggested that the Appointed Body will need sufficient authority to help manage the impacts of competition elsewhere on the system, particularly in terms of advising the incumbent networks on prioritising different types of connection requests and managing a 'clamouring' of applications from potential bidders. This is to ensure that competition does not lead to inefficient design, delays, or additional constraint costs.

Differences for competitions at the distribution level

One respondent suggested that technical proficiency ought to be given additional weight when considering competitions on the onshore electricity distribution network. This is because the distribution sector is inherently distinct from transmission, with differences in network topology; operating and design standards; and customer requirements, including delivery of assets in much quicker timescales, in part due to different planning consent regimes.

A respondent also suggested that there is no evidence to support the centralisation of competition functions (economies of scale) in the distribution sector. They suggested that this could lead to new innovative solutions to address system needs having their route to market blocked because of a lack of understanding of local needs on the part of the Appointed Body.

Disagreement on the factors set out in the consultation

Whilst most respondents agreed with the factors set out in the consultation, with one respondent calling them “practical and proportionate”, two respondents suggested that perception of bias should be addressed through transparency of process. One of the respondents argued that it would be inappropriate to choose a less well-suited body for the role due to perceptions of bias, if there was no actual bias.

Government’s analysis:

The decision on the Appointed Body will be at the Secretary of State’s discretion, so that he can take into account the relevant considerations at the time of making the decision. Most respondents agreed with the factors set out in the consultation. Having considered the additional suggestions, we think that the originally proposed factors remain the most suitable because generally the points raised by respondents are already incorporated into the factors.

In relation to *Additional Factor 1 - Commercial and delivery experience/ skills base*, we consider that the points raised by respondents are important and worthy of consideration by the Secretary of State when making their decision on the Appointed Body. We consider that the point on having a suitably experienced skills base forms part of the essential factor on ‘Technical Proficiency’ and can also form part of the consideration of the desirable factor ‘Experience in Running Tenders’. Additional costs on building a suitable skills base have been considered under the Impact Assessment’s wide range of scenarios and are accounted for when calculating the benefits that competition could realise. Therefore, while we are not adding a new factor for the Secretary of State to consider, we recommend that the points raised by respondents be included in the decision-making process.

In relation to *Additional Factor 2 – Governance Arrangements, including industry codes and standards*, we recognise the important role that industry codes and standards play in creating an economic and efficient system, where security of supply is not compromised. We do not agree that the Appointed Body needs to be bound by exactly the same codes as the incumbent network operators for these priorities to be maintained. The Secretary of State when making their decision on who to appoint should consider ‘Other Relevant Considerations’ and the ability of the Appointed Body to balance the competing needs of the system, including the design of an economic and efficient system where security of supply is not jeopardised for current and future consumers, can form part of this decision-making process. Therefore, whilst we are not adding a new explicitly described factor for the Secretary of State to consider, we recommend that the points raised by respondents should nonetheless still be included in the decision-making process.

Furthermore, the Tender Regulations and Tender Documentation, set by Ofgem and the Appointed Body, will also take these points into account. Therefore, any constraint on the network that is addressed by means of competition rather than the current RIIO arrangement, will be required to consider the needs of current and future consumers and security of supply.

Competition in Onshore Electricity Networks

In relation to *Additional Factor 3 – Authority to manage wider system impacts, including prioritisation of connection requests*, we consider that the management of wider system impacts and connection requests form part of the duties of the System Operator, separate to those duties conferred on the Appointed Body and therefore, this is not relevant to the Appointed Body. Recent experiences in relation to Pathfinders show that connection requests can be addressed appropriately in future.

Overall, we consider that the essential and desirable factors set out in the consultation are right for the Secretary of State to consider when appointing a body (the Appointed Body) to run tenders for competitions on the electricity network.

Questions 5&6: Views on appointing Ofgem, National Grid Electricity System Operator or others for competitions at transmission level

We asked:

(5) Do respondents have views on the suitability of Ofgem or NGENSO as a possible Appointed Body? (6) Are there any other bodies that should be considered as a possible Appointed Body? If so, why?

Our Decision:

In exercising their power to appoint an Appointed Body, we are minded to propose that National Grid Electricity System Operator (NGESO) is the appropriate body for the role of the Appointed Body for onshore competitions at transmission level, with the view that this function will eventually be transferred to a Future System Operator. The legislative framework will need to ensure that the Appointed Body will work closely with Ofgem, who will oversee the competitive process. This is not a final decision and will be subject to the Secretary of State's discretion at the time of the appointment.

What respondents said:

We collated the responses to Questions 5 and 6 together due to their close links. We have also considered responses to the Future of the System Operator (FSO) consultation²⁸, held jointly between BEIS and Ofgem, when considering stakeholder views on this topic. Government responded to the FSO consultation in April and committed to proceed with the creation of an expert, impartial FSO²⁹.

Responses to Questions 5&6 were not homogeneous. Some respondents expressed confidence in one or more parties having the capability to take on the role as Appointed Body, while others refrained from stating a preference for a body altogether.

Ofgem

Most respondents (albeit not all) expressed confidence in Ofgem's suitability for taking on the Appointed Body role. Key reasons for this view are summarised in the following bullet points:

- Ofgem are duty bound to ensure best value for current and future consumers.
- There will be no issues with a lack of independence, perceptions of bias or actual bias.
- Ofgem represents a central decision-making point which reduces complexity in a new regime.
- Ofgem have experience in running OFTO tenders, as well as evaluating regulatory submissions relating to planning, design, and construction.

²⁸ BEIS *Proposals for a Future System Operator* (2021) <https://www.gov.uk/government/consultations/proposals-for-a-future-system-operator-role>

²⁹ BEIS *Future System Operator Response* (2022) <https://www.gov.uk/government/consultations/proposals-for-a-future-system-operator-role>

Competition in Onshore Electricity Networks

- Ofgem regularly make licence adjustments and price changes, which will sometimes be required following a competition.

Many respondents suggested that Ofgem should have full oversight of the process if another party is appointed to the role of Appointed Body.

Of those limited respondents who expressed reservations about Ofgem's suitability to undertake the role of Appointed Body, key reasons offered are (i) they are taking a short-sighted approach to delivering net zero and network charging reviews, (ii) there is an over reliance on consultants (technical, commercial, and financial), and (iii) they do not have experience of tendering "non-network" solutions.

National Grid Electricity System Operator

A quarter of respondents considered National Grid Electricity System Operator (NGESO) as potentially suitable for taking on the role of Appointed Body. Key reasons for this view were that NGESO:

- are well placed to take a whole system view, which is important considering the scale of build that will be required for net zero.
- have technical excellence in their understanding of transmission assets and constraints.
- are experienced in technical and commercial construction contract tendering, following their work on Pathfinders and the Early Competition Plan.
- are mandated through their licensing arrangement to be economic and efficient.

However, several respondents expressed reservations over NGESO's possible appointment. Most reservations are primarily driven by concern about perceptions of bias regarding NGESO's relationship to National Grid Group. Many respondents suggested that separation should be considered essential for the system operator to undertake this role.

Another matter that concerned some respondents related to NGESO's technical capability. This is following respondent's experiences with Pathfinders projects which are not on the same scale or complexity as legislatively enabled competition. Related to this concern, some respondents questioned whether NGESO would be fully open-minded to new innovative solutions and commented on their lack of experience in tendering highly geared project financed solutions or non-network solutions³⁰. One respondent noted that there may be a tendency for over reliance on consultants – technical, commercial, legal, and financial, albeit to a lesser extent than Ofgem.

Independent Future System Operator

Over half of respondents indicated confidence that an independent system operator could and should take on this role, if established in the future. Key reasons for this view are summarised in the following bullet points, with the first bullet point being the mostly frequently expressed view:

³⁰ Bias towards certain types of solutions is a theme more fully explored in Question 3.

Competition in Onshore Electricity Networks

- Appointing an independent party would immediately address concerns over perceptions of bias or actual bias.
- An independent system operator would be well positioned to take a whole system view which is important due to the scale of change needed to meet net zero.
- After the first set of tenders, technical proficiency would start to be built up and institutionalised with time.

Many respondents did not comment on the suitability of an independent Future System Operator (FSO) or commented that it was too soon to determine if the governance structures in place for a FSO would ensure that the right skills and capabilities will be in place. A limited number of respondents suggested that a FSO should not undertake this role. Instead, they suggest that the FSO could facilitate Ofgem, who they see as more appropriately placed to undertake the role, due to their accountability to consumers and their being well positioned to determine on risk allocation.

Other parties

Generally, respondents note an upskilling process will be required for whoever is appointed to this role. Most respondents do not see any other party apart from Ofgem, NGENSO, or an independent Future System Operator as suitable to take on the role. However, some consideration was given by up to 3 respondents on the possibility of setting up a new dedicated body, appointing incumbent network operators (but constraining them from competing) or looking to the water sector for examples of alternative bodies.

Government's analysis:

For the avoidance of doubt, once the Government's proposed new legislation comes into effect, we are seeking for the Secretary of State to have the power to appoint multiple Appointed Bodies, depending on the model of competition being utilised. We intend for Ofgem to be the Appointed Body remaining responsible for running competitions for the existing Offshore Transmission Owner (OFTO) generator build tenders.

It is our view that a Future System Operator (FSO)³¹, independent from transmission asset ownership, would be the most appropriate body to be the Appointed Body for onshore transmission level electricity network competitions, with NGENSO being well placed to take on that function for onshore transmission networks in the interim. We set out reasons for this view below.

Technical Proficiency, Economies of Scale and Experience in Running Tenders

We have confidence that NGENSO and a future FSO have or will have the necessary technical skill and proficiency to undertake this role. We agree with respondents who highlighted that:

³¹ BEIS *Future System Operator Response* (2022) <https://www.gov.uk/government/consultations/proposals-for-a-future-system-operator-role>

Competition in Onshore Electricity Networks

- They are well placed to take a whole system view, which is important considering the scale of build that will be required for net zero.
- They have technical excellence in their understanding of transmission assets and constraints.
- They are experienced in technical and commercial construction contract tendering, following their work on Pathfinders and the Early Competition Plan.
- They are mandated through their licensing arrangement to be economic and efficient.

NGESO, due to their recent work in developing the Early Competition Plan, their running of Pathfinders, and their business-as-usual work in developing the Future Energy Scenarios, the Electricity Ten Year Statements, balancing the system, and more, have a unique and technical vantage and relevant experience that can be utilised in identifying projects suitable for competition, and in assessing bids throughout the whole process.

We recognise that a further upskilling process will still be required, particularly for running tenders on this scale, however, the technical skills gap for NGESO is much smaller than for an alternative, such as Ofgem. This is because Ofgem are primarily an economic regulator, and whilst they have experience in running OFTO competitions, the necessary skills base required for competition in onshore networks that will be enabled by legislation is wider than very-late model offshore competitions which Ofgem currently runs (for example, with a focus on designing the solution, securing planning consent, building the solution, or experience with tendering non-traditional network solutions). We anticipate that NGESO will be less reliant on technical consultants and will be better placed than Ofgem to build an increasingly experienced and skilled workforce. In addition, a centralisation of technical expertise and culture, given the overlap between network planning and competition roles, will facilitate the creation of economies of scale. We expect that this skills base and culture will be carried through and expanded with the FSO, particularly with the enhanced network planning functions being proposed for the FSO. The Electricity Transmission Network Planning Review consultation³² sets out Ofgem's vision for the FSO's role as a central network planner, with competition set out as an important plan of any future planning arrangements. Further detail on the FSO and its roles is set out within the FSO consultation response document³³.

We note that some respondents raised concern over a possibility that NGESO will favour certain types of solutions over others, due to their familiarity with traditional network build. However, this concern should be addressed by ensuring that the assessment criteria as defined in the Tender Documentation (including Invitation to Tender (ITT) documentation) is clear and applied equally to all bids. Please see Question 2 for more detail on the types of considerations that will form part of the assessment criteria.

Independence

³² Ofgem Consultation on the initial findings of our Electricity Transmission Network Planning Review (2021) <https://www.ofgem.gov.uk/publications/consultation-initial-findings-our-electricity-transmission-network-planning-review>

³³ BEIS Future System Operator Response (2022) <https://www.gov.uk/government/consultations/proposals-for-a-future-system-operator-role>

Competition in Onshore Electricity Networks

We set out in our response to Question 4 that the Appointed Body should be sufficiently independent of potential bidders, incumbent network companies and potential network solutions, such that it can perform functions free from bias or a reasonable perception of bias or conflict of interest, in the interests of an efficient network for net zero and consumers.

Several respondents' express their concern about perceptions of or the possibility of actual bias regarding NGESO's relationship to National Grid Group. In recognition of these concerns, we think it will be most appropriate for the FSO, independent from transmission asset ownership, to eventually become the Appointed Body. However, in the interim period, between an independent FSO being operational and legislative competition being enabled, we need to consider if this concern is sufficient as to justify not appointing NGESO when they better meet the other appointment criteria than the alternative, Ofgem.

It is important that the Appointed Body be appointed by the Secretary of State as soon as reasonably possible after legislation is enacted, enabling that body to ready itself for any competitive process for a project. We anticipate this to take some time, and the loss associated with delaying appointing a body until the FSO is formed could risk additional cost to consumers as projects which would otherwise be eligible for competition would not be tendered for.

There were enough responses in favour of NGESO's appointment that we think a significant number of potential bidders will feel confident that a competition run by NGESO will give a fair chance to all bidders. We note that NGESO is legally separated from NGET, which helps (albeit not fully) alleviate stakeholder concerns about bias and conflicts of interest. NGESO also have a history of running Pathfinder projects, where arguably similar conflicts of interest to legislatively enabled competition occur. They have been able to sufficiently deal with these concerns through use of transparent processes. NGESO are also accountable through its licence³⁴ for ensuring that any associated licensees or parties do not obtain an unfair commercial benefit from how it carries out its System Operator functions. NGESO is also obligated to maintain a safe and efficient system through its licence and wider regulatory arrangements. Furthermore, this is an interim appointment, pending the creation of the FSO.

Finally, the Appointed Body will be overseen by Ofgem, the independent regulator. Ofgem will have responsibilities for setting the assessment criteria, agreeing the needs case with the Appointed Body. Ofgem will also ultimately retain its responsibility for licensing the winning solution or regulating the contract counterparty under its licence.

With all of the above mitigations in place we are of the view that NGESO are the most suitable option for taking on the role of Appointed Body, in the interim and until such time as the FSO is prepared to take on this role when it is established.

Other relevant considerations

Whilst we welcome the comments from stakeholders who suggested we consider alternative options (such as setting up a new dedicated body or appoint network companies or look to the

³⁴ Ofgem *NGESO Special Conditions* 2.3.3 <https://www.ofgem.gov.uk/industry-licensing/licences-and-licence-conditions>

Competition in Onshore Electricity Networks

water sector for a body), we do not agree that these are suitable options. This is because we do not see these as economical options for consumers, and, as set out above, there are existing bodies which are suited to the role.

Question 7: High value threshold for late-model competition at transmission level

We asked:

Do you agree that £100m remains the appropriate threshold to be 'high value' assuming this criterion is applied to late model competition in electricity transmission?

Our Decision:

We consider that a high-value threshold of £100m is the correct point for the competition criteria, in the context of late-model competition at transmission level. We will keep this under review as the competitive market becomes more established.

What respondents said:

Whilst this question focused on whether £100 million is the correct amount to set as a high value threshold for late-model competition, many respondents made broader comments on the criteria for competition, which we include here for completeness.

Nearly half of respondents who expressed a view on this question agreed that £100m is the correct value to set the threshold at when considering late-model competition at the transmission level. One respondent cautioned that if “the “high value” threshold is reduced below this level, the potential costs of fragmentation of the energy network system would become even greater, as it would be even easier for the operator to walk away from the assets (through bankruptcy) to avoid regulatory consequences.” Therefore, this would reduce the benefits that could be derived from introducing competition.

One respondent who agreed with the £100m threshold, suggested this may need to be kept under review as competition becomes more well established.

Another respondent, who represented an investor’s view, agreed with the £100m threshold, stating that it was at a level that would allow them to absorb transaction costs and secure competitive financing.

Of the respondents who disagreed with the position set out in the consultation on setting the threshold at £100m in late-model competition, responses fell into two categories. Those who thought the amount was too high and thus would be a barrier to innovative solutions being competed, and/or those who commented on the use of a high threshold criteria itself.

Threshold should be reduced

Some respondents suggested that a £100m threshold may be too high for certain cases where larger investments can be avoided with a smart solution which can replace/ optimise the planned investment. One respondent provided the examples of a transmission substation upgrade or transformer addition being a more efficient option instead of new line. Or a Battery Energy Storage Solution combined with a lower rating transmission line instead of a higher rating transmission line.

Competition in Onshore Electricity Networks

Most respondents who thought the threshold should be reduced suggested £50m was a more appropriate alternative. Reasons for suggesting £50m include (a) Pathfinder tenders are being run for much smaller projects, and still providing value for money for consumers; and (b) allowing smaller late-model competition tenders to be run would enable a greater number of bidders to participate, with one respondent noting that a high threshold would discourage new technologies and prove a barrier to new market entrants, hindering the low-cost decarbonisation of the GB energy system.

Comments on the use of a high-value criteria

Some respondents suggested a different approach to scoping what projects should be competed. For example, National Grid ESO suggested that the approach they have proffered in the Early Competition Plan of conducting a Cost Benefit Analysis (CBA) for each project should also be considered for late-model competition.

Respondents commented that an alternative to a higher threshold, whilst still ensuring that the costs of the tender process do not outweigh the benefits, would be to adapt the tender process to the scale of project being tendered. Having shorter competitions, requiring less cost-at-risk from bidders. The scale of the problem to be fixed (say in terms of the scale of additional load that needs to be accommodated), rather than the cost of the indicative solution, might be a better way of defining whether there is a strong case for going to the lengths of holding a tender. This approach is arguably less open to gaming and more resilient to inflation etc., than a criterion based on cost.

Government's analysis:

We focus this question on late-model competition only. Ofgem consulted and have since set out their decision on early-model competition³⁵, including their views on setting criteria for early-model competition. Please see analysis of Question 1 above for our views on the value of early-model competition more broadly, when compared to late-model competition.

The Impact Assessment's 'high value' threshold for a project being eligible for competition was based on Ofgem's proposed threshold for the Competitively Appointed Transmission Owner (CATO) model.³⁶ We recognise that there may be value in a lower 'high value' threshold – however, we purposely opted to use a more conservative estimate of £100m per asset. This is because whilst a lower 'high value' threshold could increase the range of possible savings from the introduction of competition as the competitive market becomes more established, we judged that it was important not to introduce any additional uncertainty into the analysis, as this could risk overstating the future benefits of the policy.

We consider that a high-value threshold of £100m is the correct point for the competition criteria, in the context of late-model competition at transmission level. If a project was included

³⁵ Ofgem *Decision on early competition in onshore electricity transmission networks* (2022) pp.29-34

<https://www.ofgem.gov.uk/publications/decision-early-competition-onshore-electricity-transmission-networks>

³⁶ Ofgem *Draft Impact Assessment on applying late competition to future new, separable and high value projects in electricity distribution networks during the RIIO-2 period* (2020) p. 3.

https://www.ofgem.gov.uk/sites/default/files/docs/2020/08/ed2_ssmc_late_competition_ia_0.pdf

Competition in Onshore Electricity Networks

for competition on the basis of a high value but then the winning bidder put forward a solution below that high value, then this demonstrates a saving for consumers and is illustrative of the benefits in efficiency that competition can bring.

We note that as well as being generally accepted as the right level by respondents, £100m will also allow for consistency with the Large Onshore Transmission Investments (LOTI) process³⁷. This should help with providing additional clarity in the immediate term when competitions are becoming more established, on which projects are most likely to be eligible for competition.

In recognition of the comments made by respondents on the benefits of reducing this level to £50m, we will keep this criterion under review as the competitive market becomes more established. We expect that as competition becomes part of business as usual, some of the establishment and set up costs will reduce, meaning there is more leeway in terms of economies of scale, to further reduce this threshold.

³⁷ See glossary for definition.

Question 8: Competition Criteria for late-model competition at distribution level

We asked:

Are the competition criteria for projects (new, separable and high value) suitable for late-model competition at distribution network level?

Our Decision:

At distribution level, we anticipate that we will use the new, separable, and high-value criteria for late-model competition. However, we will consider further what the high-value threshold should be when we are closer to establishing competition at distribution level.

What respondents said:

Where Question 7 focused on the high-threshold criterion for late-model competition at transmission level, Question 8 instead asked respondents for their views on all the criteria for late-model competition at distribution level – i.e. whether the criteria should be new, separable and high-value.

Most respondents agreed that the suggested criteria of new, separable, and high value are the correct criteria to use.

One network company, in favour of applying the same criteria to transmission and distribution, noted the difference between Scotland and England in classification of which voltage levels are considered transmission or distribution, and commented that it would be unjust to apply different criteria to similar projects because they were classified as distribution assets rather than transmission and vice versa³⁸.

Comments on separability

Some network companies noted that there is an element of technical assessment required when deciding whether a project is 'separable'. At the distribution level this will need to reflect the radial, rather than meshed, design of distribution networks compared to transmission; and the impact on security of supply must also be a key consideration, noting that the standards of design are different compared to transmission. Another respondent suggested that the impact on network management, which takes place at a more localised level in distribution, must also be a key consideration as to whether a project can be considered separable.

Comments on high value

It is noteworthy that many suggested that £100m is likely too high a value for distribution and consideration should be given to its reduction. One independent Distribution Network Operator

³⁸ As set out in our consultation, the voltage level that distinguishes transmission and distribution is different in Scotland to the rest of GB. Therefore, if 132kV is competed in one part of GB (i.e. Scotland) and thus consumers get value from competitions there, then there is no reason not to compete 132kV elsewhere in GB (i.e. England and Wales) so consumers everywhere get the same level of benefit.

BEIS *Competition in Onshore Electricity Networks Consultation* (2021) p. 30

<https://www.gov.uk/government/consultations/competition-in-onshore-electricity-networks>

Competition in Onshore Electricity Networks

(iDNO) said that to commence competitions with a high value threshold of £100m will mean that the vast majority of projects will fall outside the scope of competition. The timescales associated with lower value projects may reduce the costs of running a competitive process and they therefore advocate for the reduction of the threshold as soon as practicable. Other iDNOs, investors and developers made similar comments, also noting that this is likely to also exclude smaller-scale innovative projects from scope.

Several respondents noted that the impact assessment published by BEIS does not assess the costs and benefits of extending competition to distribution network connected assets, and therefore suggest this type of analysis should be undertaken before determining the correct level to set the high-value threshold at.

One DNO said that economies of scale and scope are recognised in deciding whether to have multiple bodies running competitions but are ignored in considering whether to have multiple smaller network operators; the loss of scale and scope economies should be recognised in establishing the high value criteria, too.

Comments on alternative approaches

Similarly, to the comments received on transmission in Question 7 above, some respondents suggested alternatives to a high value threshold, including a focus on the type of project at hand, or seeking opportunities for bundling similar projects together.

Some respondents commented on competition that already exists at distribution-level, particularly competition in connections, suggesting that BEIS and Ofgem ought to focus on fully remedying any issues that exist in this space, before introducing legislative competition to distribution.

Government's analysis:

We focus this question on late-model competition only. Ofgem will respond on criteria for initiating early-model competition. As most respondents agreed with our position set forth in the consultation, we anticipate that we will use the new, separable, and high-value criteria for late-model competition at distribution level.

We note the comments made by some respondents on how the issue of separability may be harder to apply at distribution level than transmission level, due to its radial design. However, we disagree that security of supply should feature as a criterion for selecting projects suitable for competition. As discussed above in Question 2, security of supply should instead feature as part of how bids are assessed. We think this is the more appropriate place for security of supply to be accounted for, as there will be more information about how a project will impact on security of supply, due to the level of detail included in the bid.

We welcome the helpful comments on the risks of setting the high-value threshold at certain points, and the suggestions on how to address these. We have not come to a view on what the high-value threshold should be for late-model competition at distribution level. We will consider this further when we are closer to implementing legislative competition at distribution level.

Question 9: Views on the appointed body at distribution level

We asked:

Are there bodies other than Ofgem which have potential for consideration by Secretary of State to be the Appointed Body to run competitions at distribution level?

Our Decision:

At this time, there is not enough certainty about the future of distribution system governance to determine who we recommend as the Appointed Body for competition at distribution level. We will give further consideration to the Appointed Body following the outcome of Ofgem's Distribution System Operator governance review³⁹, and when we are closer to implementing legislative competition at distribution level.

What respondents said:

Respondents held mixed and relatively polarised views on this topic.

Most respondents acknowledged that Ofgem could perform this role, even if some of these respondents suggested that there are better candidates that should be appointed to the role instead.

Nearly half of respondents to this question expressed a strong preference for Distribution System Operators (DSOs) to undertake this role. The core reasons for this include:

- Appointing a DSO enables them to use their localised knowledge of system needs and the unique character of network topography, as well as utilising existing technical proficiency.
- DSO's can build on their established relationships with local communities and stakeholders, making sure that societal and environmental impacts are fully considered and accounted for.
- DSO's have experience with understanding planning systems, which differ across the GB system.
- DSO's have significant existing experience with competitive processes, following on from their obligations to procure flexibility first and competition in connections.
- There are parallels that can be drawn to the water sector and the Direct Procurement Model, as regulated by Ofwat, the independent regulator for water.
- A centralised Appointed Body may find it harder to accommodate these local requirements when compared to DSOs.

However, nearly half of the remaining respondents who replied to this question felt strongly that DSOs are not sufficiently independent at present to allow freedom from bias or perception

³⁹ Ofgem *Call for Input: Future of local energy institutions and governance* (2022)
<https://www.ofgem.gov.uk/publications/call-input-future-local-energy-institutions-and-governance>

Competition in Onshore Electricity Networks

of bias and therefore should not be appointed to the role. This included a network company, who stated that DNOs are not an appropriate option as they are not sufficiently incentivised to be unbiased.

One respondent commented that even if a conflict of interest is not present, the perception of bias could result in new investment not engaging in this market, with another respondent suggesting that DSO led competitions are most likely to favour traditional network build over other solution types.

One respondent suggested that if DSOs are appointed, then their affiliated Distribution Network Operator (DNO) should not be allowed to take part as a bidder in the tender.

The key reason respondents supported appointing Ofgem is they are considered independent and unbiased, and therefore provided a better and fairer alternative to DSO appointment.

Some respondents made comments on whether an independent and impartial Future System Operator (FSO), may be an appropriate choice for this role, with several in favour of this option. One respondent suggested that if the FSO is given a clear mandate to adopt a whole system approach then it may, over time, be able to run distribution level competitions - or indeed to run competitions which are agnostic as to whether the solution is provided at distribution or transmission level.

Some respondents commented on how the distribution sector is inherently distinct from transmission and therefore it would not be in consumers interest to appoint the ESO to undertake this role at distribution level. Respondents highlight that there are differences in network topology; operating and design standards; and customer requirements, including delivery of assets in much quicker timescales, in part due to different planning consent regimes. They argue that any extension of the System Operator's role into electricity distribution would likely require a significant capability and resource uplift, which would be material and may therefore not be in consumers' interests; bringing limited added value; and would likely create significant confusion and burden for stakeholders and consumers, including slowing down the delivery of infrastructure to meet legally binding net zero targets.

Government's analysis:

We welcome the helpful comments provided by respondents on this issue. We intend to introduce competition for transmission level constraints in the first instance, before expanding the framework to distribution⁴⁰. There are significant uncertainties as to what the distribution system will look like and need by the time that we are ready to extend competition to distribution. Particularly we would like further clarity on the future of DSO, a topic that Ofgem is currently considering⁴¹. Therefore, we are of the view that it is neither helpful, nor appropriate

⁴⁰ Note – the framework that enables competition across electricity networks will be included under the same framework within primary legislation. The introduction of competition at transmission level, and then distribution will be timed by the exercise of secondary legislation powers and so can be staggered.

⁴¹ Ofgem *Call for Input: Future of local energy institutions and governance* (2022)

<https://www.ofgem.gov.uk/publications/call-input-future-local-energy-institutions-and-governance>

Competition in Onshore Electricity Networks

to consider and indicate who we might anticipate becoming an Appointed Body for the competition on the electricity distribution network at this stage.

We will revisit this decision when we are closer to implementing competition at distribution level.

Other Comments and Themes

We note that some respondents had comments on wider matters than those we specifically were consulting on. These wider comments link to the introduction of onshore competition more generally. The section below sets out summaries of some of these comments, and where in a position to do so, we have responded with the Government's view.

Impact Assessment

Some respondents provided feedback on the Impact Assessment published alongside the consultation. We have taken the helpful comments into account and will continue to build up robust analysis now and as this framework develops and extends to cover more areas of the electricity network.

Competition that already exists

Transmission

We note that some respondents highlighted competition that already takes place under the existing processes and frameworks that operate in onshore electricity networks. For example, Transmission Owners use competition throughout their supply chain and procurement processes, and Ofgem work to ensure they are delivering energy infrastructure both economically and efficiently for energy bill-payers.

Some respondents drew attention to the benefits that competitive tendering of electricity network infrastructure has had in the offshore wind sector. They state that given the pace of change that is needed across onshore electricity networks in the coming years, the benefits that the introduction of competition could bring onshore, such as to increase sources of capital, are well understood.

We welcome where there are examples of competition that already take place in electricity networks. We believe that the efficiencies that have already been made can be built on through the introduction via legislation of a framework to enable competition and highlight the estimated cost savings in our impact assessment: £1 billion over 10 years⁴².

One respondent observed that many elements of the early-model competition model are similar or identical to the current Network Options Assessment (NOA) Pathfinder projects and asked for further clarification around future interactions between the proposed competitive framework and existing competition processes and market mechanisms. This is because they are not convinced that full separation from existing frameworks (i.e. legislative competition in addition to Pathfinders competition) is achievable. A legislative framework for competition is intended to create a marketplace to find new and/or innovative efficiencies in design, build, operation and financing of the network, inviting new solutions and parties to participate. This will build on existing competitive processes in the electricity network, like Pathfinders and

⁴² BEIS *Competition in Onshore Electricity Networks Impact Assessment* (2021)
<https://www.gov.uk/government/consultations/competition-in-onshore-electricity-networks>

Competition in Onshore Electricity Networks

DNOs' flexibility tenders. Existing legislative arrangements allow for licensees to run competitive tenders for the delivery of established services they deliver under their licences, but limit Ofgem's ability to award onshore transmission licences on the basis of a competitive tender process. The proposed legislative framework is therefore necessary to ensure that a wide range of solutions are able to compete in robust and transparent tender processes supported in legislation.

Distribution

A network company respondent expressed concern that competition in electricity distribution networks could negatively cut across many of the vital net zero programmes already underway, including flexibility tenders and the role of the DSO in co-ordinating network planning and operation. Particularly they note that many early-model competition objectives could be delivered in the distribution sector through DSO functions by considering flexibility solutions as an alternative to network reinforcement solutions. Any early competition framework should therefore flow from the DSO functions and capabilities agreed for RIIO-ED2.

The same respondent highlighted the existing use of competition in several areas across their business, designed to realise similar types of benefits. This includes the procurement of flexibility services, and competition in connections through a competitive procurement process (i.e. by meeting the requirements of the Utilities Contracts Regulations 2016 and benchmarking with the other DNOs). Other network company respondents made similar points.

The framework that we are introducing is designed to support and run in tandem with other cross-cutting policy areas, such as the work on flexibility tenders that are already operational. As noted above in Questions 8 and 9, we will continue to work on how this policy should apply at distribution level, to ensure that the benefits of competition are fully realised fairly, balancing the needs of different groups of stakeholders.

Whole system thinking, holistic system designs and network planning

Several respondents noted factors that policy relating to onshore competition in electricity networks should consider in situating itself in the wider system. This included consideration of the relationship between onshore and offshore network planning and ensuing competitions and the role network owners in network planning and running competitions.

The Government's intention is to create a framework for network competitions that allows for flexibility to suit the grid's needs now and in the future. As noted in the consultation document, there are a range of projects which are ongoing which will influence the future direction of the electricity network, including the System Governance Review, the Offshore Transmission Network Review, the Electricity Transmission Network Planning Review and consideration of Distribution System Operation. We acknowledge the overlaps present may change network planning and governance significantly, and that any competitive framework should be adaptable to these various scenarios. Policy teams across BEIS and Ofgem are working closely with stakeholders as these workstreams evolve and will continue to do so, ensuring onshore and offshore network planning feeds into an efficient competitive framework where

Competition in Onshore Electricity Networks

appropriate. We will continue to engage with system governance work, as Secretary of State considers the body to appoint to run tenders.

Comparison with competition in retail market

Several respondents expressed concern that to introduce competition in electricity networks could lead to the risk of market participants failing and a similar situation to that in retail arising, where companies fail, and consumers' money is lost and security of supply at risk. The Government and Ofgem take any risk to security of supply seriously and work to ensure all energy policies protect the overall security of the electricity system. As such, we will continue to work to ensure the correct security of supply provisions are built into any tender for onshore electricity network, including consideration of bidders' experience in the field and financeability as well as the suitability of the solution proffered to solve the constraint at hand. Moreover, competition in networks is a very different market to the retail market. Whilst free market principles govern the retail market, those successful bidders for network competition will be overseen by the Appointed Body and the regulator, Ofgem, on appointment and on an ongoing basis.

Conclusion and Next Steps

Responses from stakeholders have been helpful, informative, and constructive in supporting us to make decisions on the implementation of onshore competition set out in this Government response.

The range of responses show that the benefits that can be realised from enabling competition are far reaching for consumers, communities, and businesses across Great Britain. We believe that allowing new parties to compete for onshore electricity network projects will deepen the pool of capital available for the significant amount of investment needed to transform our electricity networks as we transition to net zero. It is clear that there is an appetite from third parties to enter this market, and that competitive pressure is likely to encourage further innovations in system design and operation, saving consumers money as investment in net zero networks increases to meet 2050 needs.

The decisions that we have included in this Government Response should provide more clarity and certainty about the way the competitive framework will operate for onshore electricity networks once we have the relevant legislative powers⁴³. We recognise that certainty of delivery model is useful when network planning and so we will continue to engage with stakeholders on a regular basis and work with Ofgem as this policy develops further.

⁴³ We committed in the Energy White Paper 2020 to legislate when Parliamentary time allows to enable competition to build, own and operate onshore electricity networks.

Glossary

Appointed Body

The body appointed by the Secretary of State to run competitive tenders under the legislative framework. For the avoidance of doubt, we intend to enable the Secretary of State to appoint multiple Appointed Bodies, depending on the model of competition being utilised. This consultation response refers to an “Appointed Body” because this is the language that was used during the consultation and in responses from stakeholders. The Energy Security Bill refers to the designation of a “delivery body”. For all intents and purposes, the “Appointed Body” and “Delivery Body” are the same entity, and any reference in this document to “Appointed Body” can be read as the same as “Delivery Body” in the Schedule 12 of the Energy Security Bill.

Distribution Network Operator (DNO)

DNO stands for distribution network operator. It’s the company that owns and operates the power lines and infrastructure that connects homes and commercial properties in an area to the electricity transmission network. DNOs in Great Britain are regional monopolies.

Distribution System Operation / Operator

Distribution System Operation is a set of functions and services that need to happen to run a smart electricity distribution network.

Some respondents have used the term Distribution System Operator to refer to an entity responsible for Distribution System Operation. There is currently no single party acting as a Distribution System Operator, instead, we recognise roles for a range of parties to deliver Distribution System Operation.

Electricity System Operator (ESO)

The ESO has a central role in our energy system. It performs several important functions from the real time operation of the system, through to market development, managing connections, and advising on network investment. On 1 April 2019, the ESO separated from National Grid Electricity Transmission (NGET) and became a legally distinct company within the National Grid Group⁴⁴.

Final Needs Case Assessment

Under the terms of the Large Onshore Transmission Investment (LOTI) mechanism in RIIO-2 the Final Needs Case is the assessment stage at which Ofgem provides final regulatory approval for proposed network company investments of over £100m. It is normally expected to

⁴⁴ Ofgem *RIIO-2 Final Determinations – Electricity System Operator (REVISED)* (2020)
<https://www.ofgem.gov.uk/publications/riio-2-final-determinations-transmission-and-gas-distribution-network-companies-and-electricity-system-operator>

Competition in Onshore Electricity Networks

align with the finalisation of planning approval for the project. Further details of the Final Needs Case are provided in the LOTI guidance document⁴⁵.

Future System Operator

Government and Ofgem have recently published our consultation response setting out our commitment to proceed with the creation of a Future System Operator (FSO). The FSO will be an expert, impartial body with responsibilities across electricity and gas and an important duty to facilitate net zero whilst also maintaining a resilient, and affordable system. It will be based on the current Electricity System Operator (ESO) and forward-looking elements of the Gas System Operator (GSO). We will establish the FSO in public ownership, in a way which ensures it is independent of asset ownership, other commercial energy interests and day-to-day operational control of government. As a trusted and expert body at the centre of the gas and electricity systems, the FSO will play an important role in coordinating and ensuring strategic planning across the sector and providing independent advice to government and Ofgem. More detail on our decisions on the FSO and next steps can be found in our consultation response⁴⁶.

Initial Needs Case Assessment

Under the terms of the Large Onshore Transmission Investment (LOTI) mechanism in RIIO-2 the Initial Needs Case is the assessment stage that comes ahead of the Final Needs Case. It takes place ahead of any planning approval being sought but once the design of the project is unlikely to change. Further details of the Initial Needs Case are provided in the LOTI guidance document⁴⁷.

Large Onshore Transmission Investment (LOTI)

The Large Onshore Transmission Investments re-opener (LOTI re-opener) provides electricity Transmission Owners (TOs) with a route to apply for funding for large investments in the network, for example that may be required during RIIO-2 to meet decarbonisation or system reliability needs.

Projects coming through the LOTI re-opener would not have been funded at the time of setting the price control due to insufficient certainty regarding their need, scale and/or timing.⁴⁸

Network Options Assessment

The Network Options Assessment (NOA) is National Grid Electricity System Operator's recommendation for which reinforcement projects should receive investment. These projects

⁴⁵ Ofgem *LOTI Reopener Guidance* (2021) <https://www.ofgem.gov.uk/publications/large-onshore-transmission-investments-loti-reopener-guidance>

⁴⁶ BEIS *Future System Operator Response* (2022) <https://www.gov.uk/government/consultations/proposals-for-a-future-system-operator-role>

⁴⁷ Ofgem *LOTI Reopener Guidance* (2021) <https://www.ofgem.gov.uk/publications/large-onshore-transmission-investments-loti-reopener-guidance>

⁴⁸ Ofgem *LOTI Reopener Guidance* (2021) <https://www.ofgem.gov.uk/publications/large-onshore-transmission-investments-loti-reopener-guidance>

Competition in Onshore Electricity Networks

are major electricity transmission network reinforcements as defined in the NOA methodology⁴⁹.

RIO

Ofgem set price controls for the gas and electricity network companies of Great Britain. Price controls balance the relationship between investment in the network, company returns and the amount that they charge for operating their respective networks.

RIO-2 is the second set of price controls implemented under the RIO model. RIO stands for Revenue = Incentives + Innovation + Outputs. It's an investment programme to transform the energy networks and the electricity system operator to deliver emissions-free green energy in GB, along with world-class service and reliability⁵⁰.

Tender Documentation

These are the detailed documents that bidders will need to use when taking part in a competition. This may include items such as the Assessment Criteria, Invitation to Tender Documentation and information on the network need.

Tender Methodology

This is the detailed process followed during a tender, set out in the Tender Documentation (see definition above).

Tender Regulations

This is the regulatory framework that will set out how the competition will operate. The process may differ depending on the model of competition used, for example the stages, parties and process for early-model competition will not be identical to the existing Offshore Transmission Owner (OFTO) competitions.

Transmission Owner

Transmission Owners (TOs) are the network companies that build the transmission network. The transmission network carries electricity at high voltages over large distances, from large generators and into the local electricity distribution network. TOs in Great Britain are regional monopolies.

⁴⁹ National Grid Electricity System Operator *NOA Methodology* (2022) <https://www.nationalgrideso.com/research-publications/network-options-assessment-noa>

⁵⁰ Ofgem *Network Price Controls and Performance* (2021-28) <https://www.ofgem.gov.uk/energy-policy-and-regulation/policy-and-regulatory-programmes/network-price-controls-2021-2028-rio-2>

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