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Citizens Advice Response to ESO Early Competition Plan Phase 3 Consultation

Dear ESO Early Competition Team,

Citizens Advice welcomes the opportunity to respond to this consultation as part of its statutory role to represent domestic and small business energy consumers in Great Britain. Our response is not confidential.

We have provided a perspective on the materials provided so far and look forward to the development of the final iteration.

An overview of roles and responsibilities in early competition

Background

The National Infrastructure Commission (NIC) report 'Strategic investment and public confidence' stated the need for the regulatory environment to facilitate the low carbon revolution and highlighted a need to open up the energy markets to new players and ideas. The NIC suggests *"that most major strategic investments should be removed from the price control processes, where appropriate, and opened up to competition to support innovation"*¹.

In response to RIIO-2 consultations, we have encouraged Ofgem to consider which major strategic investments would be appropriate to be outside the price control

¹ National Infrastructure Commission (2019) [Strategic investment and public confidence](#)

Patron HRH The Princess Royal **Chief Executive Dame Gillian Guy**

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process and be put to further competition beyond the network companies. We encourage mechanisms and assessments for such investment which will need to be robust to ensure that consumers get a positive return from this initiative.

Citizens Advice is contributing to the ESO Networks Stakeholder Group (ENSG) work on early competition and support the work of the ESO in developing a proposed model. We believe this work presents an opportunity to increase innovation across planning, design, construction, finance, operation and maintenance of assets in network projects. This would support service benefits and cost savings to consumers.

Positive outcomes from early competition require alternative delivery options from third-parties that offer advantages over proposals from monopoly networks. However, we are conscious that there are natural resource synergies of network planning being vertically integrated with network delivery and operation in a Transmission Operator (TO). TOs are funded to plan and deliver their networks and it is in consumers' interests this resource is best utilised.

As noted by the ESO, these responsibilities are split from network delivery into different organisations in some countries. These roles are within the TO in Great Britain - and we see strong advantages of this approach - but it will make it difficult to create a neutral platform for competition against a monopoly network planner and operations provider. This has been raised by stakeholders in earlier consultation phases of the ESO's work. The incumbent and other TOs have significant advantages that need to be monitored and addressed, including connection process, energy cost, cost of capital, user charges and land and development rights.

The ESO role

There will be an inevitable cost of introducing and operating an early competition process and we are keen to see early competition complement the price control process as effectively and efficiently as possible. In electricity transmission operation and in electricity system operation there is already a developing process between the TO and ESO via the Network Options Assessment (NOA) to coordinate system planning to improve overall system performance. It is an efficient starting point, but the existing process predisposes a localised price-controlled monopoly and this likely needs significant change to frame network options suitable for 'interested persons' or early competition processes.

We expect that to take early competition forward with a realistic prospect of fair competition, the ESO will need to strengthen its challenge and review its role in network planning. We support the ESO's proposal in this regard. It needs to provide an extensive challenge of TO proposals on all aspects of project detail and definition. This will require the ESO to have the skills to identify the project parameters that can proactively facilitate the integration of third-party solutions to realise the benefits of early competition. To best achieve this outcome we support the ESO proposal to avoid very early stakeholder engagement to ensure the ESO takes adequate ownership of the scope for the initial proposal and the targeting of the relevant stakeholders. Stakeholder engagement should then become a critical tool in the development of project definition.

We think that Ofgem's request of the ESO to introduce an Interested Persons options process to enable third-parties to also submit potential solutions into the planning process will help build these competencies. We also believe that the proposed expanding of the scope of projects under the NOA can support awareness of which connections, compliance, asset replacement and voltage/stability projects might be suitable for early competition.

The incumbent TO role

We think it is in consumers' interests that RIIO-funded activity utilises an incumbent TO's local knowledge, experience, and expertise of network planning to support the development of project requirements for early competition. However, with the support of stakeholder input, the ESO will need to ensure a project's framing informed by the incumbent TO is sufficiently neutral of delivery options to encourage bids that maximise value and service outcomes for consumers.

We think the terms on which TOs can participate is vital from a consumer perspective for driving standards and realising benefits from an early competition process. The incumbent TO should be able to operate efficiently but shouldn't have an unfair advantage over other bidders. To support this outcome we support the ESO in exploring how the incumbent TO can maximise its data and asset openness to potential bidders. This minimises the risk that TO assets that have already been paid for by consumers are not made available for market solutions and the market having to replicate existing TO capabilities.

Incumbent TO as equal bidder in early competition

The ESO stated under its updated preferred option from Phase 2:

"The TOs are well placed to deliver competitive bids which benefit consumers due to their expertise in delivering such projects and will therefore increase competitive pressures. Incumbent TOs also have the potential to utilise their existing assets within their bid, which would not be the case if the TO's parent company participates through a separate entity."

We think this statement makes it clear why it is not optimal for an incumbent TO to directly compete in the early competition process. As a TO responded to the Phase 2 consultation: TOs aren't used to running in competitive tendering processes. The ESO also states *"that the regulatory and competitive regimes are fundamentally different"*. So TOs are both at a clear advantage with access to consumer funded network assets and shouldn't be assumed to be skilled to the exact demands of the task.

In support of a counterfactual incumbent TO proposal

The ESO raises a number of concerns about an incumbent TO bidding as a counterfactual. Primarily, that it would be difficult to compare a RIIO funded proposal and a competitively procured bid. We think that this comparison is important to ascertain whether early competition offers consumers a better outcome than the counterfactual. This assessment requires a process that accounts for costs, model alignment with a service period and the relative RIIO incentives and obligations between a counterfactual TO under RIIO, or with a competitive bid from TOs under a competition process or a third-party provider. Although more complex, we think this comparison is central to assessing the value of the early competition process. It is the counterfactual of not introducing early competition.

The counterfactual approach is compatible with the cost-benefit analysis (CBA) proposal for identifying early competition projects. It also enables an understanding of the value of early competition to consumers as a whole including the complete running costs of early competition such as the unsuccessful CBAs. This will be important for transparently determining when early competition should be used in future. We support ESO ambition about expanding the areas and size of the project where early competition will be applicable, but this needs to be driven by a solid evidence base.

Without this process, there would seem a high risk of it not being viewed as fair competition as the incumbent TO should provide network planning direction to the ESO.

TOs' network planning through RIIO is funded to contribute to the best delivery solution and outcome for consumers. It also does not seem fair on other bidders or the right incentive on a TO to allow a separate bid team from an incumbent TO to develop a second proposal when faced with competition.

It would seem appropriate - given the opportunity to define a proposed default/counterfactual option as a RIIO commitment, that an incumbent TO progresses their proposal to a requisite stage of development to be a comparator. A CBA will inevitably require a view on an outcome without early competition. This might be clear from an early stage or only after what the ESO describe as 'Tendered stage 1' or 'Tendered stage 2'. We would suggest that a counterfactual is appropriate to be requested from the incumbent TO while they remain competitive. We think there is an argument to make the incumbent TO proposal public as it is a consumer funded proposal that is a marker to encourage third-party bidders to consider in the formal bidding and encourage competition. A counterfactual from the incumbent TO provides a fallback option for the ESO should the competition process prove uncompetitive or a costly option.

If the ESO has a framing role of an early competitive project that requires approval from Ofgem there should be good accountability for consumer outcomes. Therefore, we support other TOs, who are not involved in the local network planning process, being able to bid in a competitive process as proposed, including separate bidding teams. The conflict of interest and advantages will be less pronounced.

Where multiple networks are potentially an incumbent both would contribute to network planning and would be competing to be the preferred counterfactual that is taken forward in early competition.

The TOs potentially offer distinct value propositions from a third-party bidder given their broad role in RIIO for network delivery and these attributes should be quantified in comparison to a third-party bid. The way a TO approaches a bid is likely to have synergies with its other activities and this should be accounted for. Otherwise, consumers will lose out through a narrowly defined early competition project scope when a wider view highlights further network benefits. This will likely be for the role of approver to assess but should be factored into the process design. The consumer interest is in innovative network delivery options that are delivered by efficient providers. However, to establish the best options, there needs to be clear accounting for

the TO advantages and an informed appraisal of their proposal relative to third-party providers.

A different approach from late competition

We note that open competition is consistent with Ofgem's model for late competition in allowing all TOs to compete. However, early competition is fundamentally different because what is being tendered is an element of creative network design and planning in the provision of a network solution. We also think this model will be even more problematic for early competition in distribution networks where neutrality and scope to innovate in local distribution solutions is needed to support flexibility of the grid, smart local energy systems and harnessing innovative consumer behaviour change to achieve net zero. Future clarity around DSO and DNO functions could potentially be undermined by obscurity around responsibility for network planning in early competition. It would also be let down if there is a limited expertise model in opening up projects to alternatives to network reinforcement

Harnessing expertise, independence and oversight in early competition

Given that our preference is for a cost-efficient and streamlined early competition model, we broadly favour drawing on existing publicly funded expertise and resources to be utilised for delivering the early competition process, with oversight from the approver role. Particularly when providing cross-checks, validation or assurance processes where deep knowledge is needed for a short process. Where the objectives of the early competition process can be met with sign off from an approver utilising the ESO, particularly where it has existing competencies, seems appropriate. Even more so if it was fully independent of National Grid.

Copied below are comments about how we view the individual roles outlined in the consultation.

Response to question 1 and 2

Approver - We agree with the activities proposed for the approver and that this should be Ofgem.

It is appropriate that they take a decision to conclude the stages of early competition, confirm the need for competition and select the preferred bidder.

We think that alongside the proposed checks we would also want the approver to have a check and assurance role that the network planning body has identified and framed a need in a way to maximise fairness and transparency. Similarly, to have a role in checking that the tender exercise is completed through a fair and transparent method so that they are fully informed to make the choice about whether to proceed with a preferred bidder. It is also important that the approver helps protect consumer value at the post-tender stage if a solution which wins a tender subsequently fails to deliver.

Response to questions 3 and 4

Procurement body

We think that the ESO is well placed to run this process given its existing expertise. However, we recognise the lack of existing competencies in certain areas - we feel that this could be met through internal resourcing or through procuring specialist services. We assume this will be the most efficient option but would also be open to a third-party overseen by Ofgem if there are procedures linked with the approver that are particularly beneficial to prioritise. We agree that independent assurance is not required - as long as the approver has an oversight role.

Questions 5 and 6

We support the ESO views on contract counterparty and payment counterparty.

Question 7

Our response to this question is provided in detail above.

Question 8

We support the findings on the limited applicability of the examples provided.

Chapter 7 Early Competition Plan: Early competition in distribution

We welcome the consideration by the ESO of early competition within the distribution sector as highlighted in our response to the ED2 Sector-Specific Methodology

consultation (SSMC)², as we believe that there are opportunities to encourage more competition, particularly for the new Distribution System Operation (DSO) systems and functions.

We support the ESO in considering opportunities to include competition outside the price control process. As an example, the £950 million announced within the Energy White Paper for improving the energy infrastructure of motorways and major 'A' roads could be an example that in the future would be suitable across TO and DO early competition bidding processes.

Early competition in distribution networks

In our response to the RIIO- ED2 SSMC³, we noted that there may be efficiencies for consumers that may be generated by early competition for DSO functions, such as for shared IT systems and services, as well as better collaboration across DNOs. We support the ESO looking at collaboration between DNOs in designing and implementing systems, infrastructure or processes, and putting these projects out to competition. This may be particularly applicable for new DSO functions, as it may be more cost-effective for consumers to increase standardisation and reduce the duplication of DSO systems. In this scenario, some form of collaboration may also complement competition with third-parties.

There will be wider energy system governance issues which may lead to changes in DNO structures which may provide further assurance regarding apparent conflict positions at the DNO level. These changes, if any take place, may be relevant to assist in ascertaining whether any separate DSO body or bodies, may be optimal. The current DNO structure without separation of DSO roles does not appear to provide a sufficient level of assurance for independence.

Procurement body

We note within the ESO Early competition plan consultation (Chapter 7, page 8) that the proposed procurement body could include a number of institutions, such as the ESO, a Third Party, or the DNOs.

² Citizen Advice (2020) [Citizens Advice response to Ofgem RIIO-ED2 Sector-Specific Methodology consultation](#)

³ *ibid*

We have noted in various prior consultation responses that there is an apparent conflict between the DNO and DSO roles and have encouraged greater transparency between the boundaries of DNO and DSO functions, separation of costs, revenues and incentives, as well as asking for a wider review of DNO/DSO roles and functions. In a similar vein, as with early TO competition, any procurement body that makes recommendations or decisions for early competition in the distribution sector will need to be independent.

Network planner, Approver and Licence Counterparty, Contract Counterparty

As with TOs, we agree with the view that the network planning role should remain with the DNOs. However, we have advocated that forecasting may be better placed within a more independent DSO or other body, as at the transmission level.

We agree that the Approver and Licence Counterparty roles should be with Ofgem as the Licence role fits solely with the regulator, and having the Approver role sit with Ofgem will provide additional scrutiny and assurance of the process.

We support the view that the Contract Counterparty should be the DNO given their contract experience and ability to monitor the contract to ensure appropriate completion. Suitable assurance measures by Ofgem or another independent body can provide stakeholder confidence for DNOs as Contract Counterparties.

Payment counterparty

We note that the ESO believes that it is best placed to undertake this role at the transmission level. It may also be valuable for an assessor body to be the payment counterparty at the distribution level to provide assurance to the process.

Additional roles, including the Network Options Assessment (NOA) process

We see value in a distribution level NOA process with a broad scope. We recognise that the threshold value for consideration may need to be reduced for distribution assets and will need to incorporate the full gamut of options (e.g. including reinforcement, flexibility, energy efficiency, or deferral until better knowledge is in place).

There may be value for other roles, such as the Best Practice Coordinator, to be external to the DNOs. However, we believe that the forthcoming review on energy system governance, which may consider DNO/DSO roles and functions, may assist in providing further opportunities for assurance on additional roles within the distribution sector and it may be premature to consider these additional roles until that review is concluded.

Kind regards

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