

Dear Mr Jones,

Thank you for your email of 15 January, which raises concerns DGAP have in relation to SPEN's stakeholder engagement process and evaluation of different reinforcement options. It also raises a number of specific questions about the Strategic Wider Works (SWW) assessment process and the interactions with the new enhanced system operator role of National Grid, and lastly queries when we would look at whether to tender the project.

We are not in a position to respond on a point by point basis to the issues raised in relation to SPEN's engagement process in the Dumfries and Galloway area or the options it is considering for developing the network. This is because we have not yet received or assessed a needs case submission from SPEN on the potential reinforcement options. However in this email I try to explain the context in which the network companies make decisions around new network developments, the range of factors they need to balance, and also the nature of Ofgem's role within the Strategic Wider Works (SWW) process more generally. I respond in more detail on some of the specific questions you asked about how the SWW assessment process interacts with enhanced System Operator (SO) role, and the implementation of competitive tendering of large transmission projects in future.

I understand that a meeting in March between members of DGAP and Ofgem is being arranged through Joan McAlpine's office, so I hope this response will be helpful for informing a future dialogue. I will likely attend that meeting with other colleagues.

Formulating network development plans and stakeholder engagement

The transmission companies have a duty under Section 9 of the Electricity Act to build and maintain an efficient, coordinated and economical transmission system. In formulating network plans, the transmission companies also have statutory duties to have regard for the desirability of preserving the natural beauty and special features of an area its lines will pass through, and to take reasonable steps to mitigate the impacts of proposals (Schedule 9 of the Electricity Act). For a new transmission project, we interpret this to mean that a company must develop network plans that meet the necessary technical requirements, are economically viable, and include reasonable measures to avoid unacceptable disturbance to the host environment and the people who live, work and enjoy recreation within it.

It is the responsibility of the company to identify what investment is needed in their networks to meet both customers' needs and their statutory obligations and obtain planning consent for their development. In doing so, the company must reconcile a number of factors, including the impact of its proposal on the local environment and local communities with the cost to consumers of minimising that impact. They are also required by planning law to take stakeholders' views into account as part of this process and to follow available planning guidance from either the UK or Scottish government about the impacts of new developments that should be avoided or mitigated if reasonable to do so.

Planning decisions are taken by the planning authorities working with the transmission operators. In the case of the DG proposal, the Scottish ministers will decide on whether or not to grant consent for the proposal after SPEN submit a planning application to the Scottish Energy Unit. Ofgem doesn't have a direct role in the planning and consenting process of new projects. As economic regulator of the energy industry, our primary duty is to protect the interests of existing and future consumers. One way in which we do this is by regulating the network companies through price controls. We set price controls to specify the services and level of performance that the TOs must provide for users and consumers and to restrict the amount of money that the network companies can recover through network charges over the length of a price control period. As part of setting the price control outputs and revenue cap we encourage the network owners to genuinely engage with its stakeholders about the outputs it is accountable for and how it intends to carry out its licenced activities, so that its plans are informed by stakeholder feedback (as explained in the RIIO handbook).

To meet our primary duty in respect of large investments in the transmission system we must be satisfied there is a well-justified need for the project, before we allow a company to recover the efficient costs of building it from consumers. In our assessment, we'll review the factors that are driving the need for the project and the range of options a company has considered. We'll compare the efficient costs and the benefits of the proposed solution against other viable solutions to assess

whether the company has justified its preferred option. This process is intended to assess the initial strength of the investment case for the project and reasoning behind the company's preferred proposal. We consult on our assessment of the needs case, and set out our views on areas where we think further work or evidence might be required to justify options. This is intended to help ensure our regulatory process works effectively and raises any issues in a timely manner so that they can be addressed.

In assessing the recoverable costs of new transmission projects, we require the company to show its proposal is efficient. This is reliant on a project reaching a certain maturity which will depend on the company's ongoing development and procurement work, stakeholder engagement on the project and the outcome of the planning consents process as well. Generally our assessment of efficient costs involve the company providing information on the least cost option, as well as information to justify additional costs on top of this that it considers necessary to address the proposal's impacts on the local environment and/or communities. The transmission owner can do this by explaining the impact of the least cost option and how the alternative route or additional measures it is incorporating into its proposed design are justified. In coming to a decision on the funding that can be recovered from consumers for a proposal we will also take into account the outcomes of the planning and consenting process.

Further information on our role in the context of conserving natural beauty can be found on our published fact sheet, available at: www.ofgem.gov.uk/sites/default/files/docs/2013/07/visual_amenity_factsheet_final_english_0.pdf

SWW assessment, interactions with the enhanced System Operator role and tendering of projects

- Response to questions 11, 12 & 13:

We recently reviewed our SWW assessment process following experience with earlier SWW projects. We have introduced a new assessment stage that takes place earlier in a transmission owner's development of a new transmission reinforcement project. This is called the initial needs case. This assessment will start when a TO has identified a reinforcement option but before it has completed its detailed scheme development or its stakeholder consultation process. The purpose of the initial needs case is to assess a transmission owner's process and analysis for identifying its preferred reinforcement options ('optioneering') and to give our views on the need for a project and the potential scope (e.g. sizing and technology choice) at an earlier stage of its development. In particular we would seek to identify areas where we think further work or evidence might be required to justify options. This is intended to help ensure that the regulatory process works effectively and raises any issues in a timely manner so that they can be addressed sooner.

We plan to publish an update to our SWW guidance document in 2016 for the introduction of the earlier assessment stage in our SWW process and to outline the interactions with how we will implement competitive tendering for onshore transmission (we published a consultation on this in October 2015). Ahead of this we will update our SWW webpage to provide further information about the new earlier assessment stage in the SWW process and how this relates to external milestones for the development process of a new transmission project. This indicative timeline will refer to the stages of the developer's external consenting process.

- Response to questions 14, 15 & 16

National Grid has published a methodology on its website setting out how it will assess network options <http://www2.nationalgrid.com/UK/Industry-information/Future-of-Energy/Network-Options-Assessment/>. As part of this it includes an explanation of how options to meet future network requirements will be identified. This includes potential non-build options such as commercial arrangements.

NG has licence obligations to present an independent view under the enhanced role requirements. If we consider that NG is not fulfilling the requirement of its licence, we can take enforcement action, including imposing financial penalties.

NG's view and assessment of options will most likely, in the first instance, precede our assessment of SWW proposals. The NOA report will be an annual publication that indicates potential network

reinforcement requirements for a period of 10 years. Accordingly we would expect new reinforcements to appear in the NOA report in advance of a company submitting a SWW needs case. It is possible that a SWW needs case submission could be made ahead of the first NOA due in March but in general we expect the NOA report will precede SWW submissions from the TOs in future. NG, in its enhanced role, will also undertake analysis on projects that are submitted as SWW proposals. NG's methodology (same link above) provides further information on the analysis and process that it will carry out for SWW proposals.

- Response to questions 17 & 18

In October we published a consultation on implementing competitive tendering of onshore transmission

assets https://www.ofgem.gov.uk/sites/default/files/docs/2015/10/ecit_consultation_v6_final_for_publication_0.pdf . This sets out our further thinking on the criteria for tendering projects and also the different tender models and when we would be likely to take decisions on tendering an onshore transmission project. We proposed to assess all future SWW proposals for their suitability for tendering against the criteria in the consultation. This would take place when a company has made a SWW submission to us for our consideration of the needs case. We will most likely give a view on the potential suitability for tendering a project at the initial needs case stage, with a final decision on whether to tender a project at the final need case decision.

- Response to questions 19.1 to 19.8

19.1 There isn't a set value for the cost of constraints. This is calculated based on modelling of the generation mix on either side of the network constraint and the accepted bid prices, which are related to the short run marginal costs of energy production by:

§ the generation plant upstream of the constraint that agrees to withhold exporting power onto the grid, and

§ the generation plant downstream of the constraint that agrees to start or increase its output onto the grid to make up the shortfall in power supply.

19.2 We have several approaches to ensuring there is a robust economic case for the proposed investment depending on the characteristics of the expected generation background. In a situation where there is a portfolio of generation projects behind a reinforcement we test the investment case for different generation scenarios to determine if there might be a potential regret (negative net present value) in the event a smaller amount of generation comes forward than is contracted. We look at various factors such as the subsidy regime, the consent status of the generation and historical build out rates of generation to inform us whether the different generation scenarios cover a reasonable range of uncertainty.

19.3 In the project assessment we undertake the detailed cost assessment of the proposal that the transmission owner has obtained planning consent to build. We undertake this assessment and consult on our view of the efficient costs of the consented project. In the past the SO has not been involved in this stage. However, the SO might need to be involved in future to carry out a further iteration of the economic evaluation that the SO carries out on all SWW projects in the event that the project costs changed significantly from those that were considered at the time of the needs case.

19.4 The CBA covers the project's lifetime, i.e. a 45-year window, which is generally considered long term by the standards of typical CBA. If there are significant factors beyond this window, the TO is able to highlight these in its needs case submission and justify why these are relevant considerations.

19.5 As the regulator of the gas and electricity markets, our decisions affect individuals and businesses across Great Britain both now and into the future. Accordingly we adopt a broad view of stakeholders as all parties that have an interest in our work. Our consultations on SWW are open to all individuals and groups and usually follow our published guidance on consultations (see https://www.ofgem.gov.uk/sites/default/files/docs/2011/12/guidance-on-ofgems-approach-to-consultation_0.pdf)

19.6 The final needs case assessment stage outlined in the published guidance generally follows the transmission owner's public consultation stages, and likely to be after the planning application is submitted. The project assessment stage (and our decision on the efficient project costs) will follow planning approval (consent granted) once there is sufficient certainty about the factors driving the project, the final design of the project to be built, and information from the transmission owner's procurement exercise on the costs. Our cost assessment is reliant on a project reaching a certain maturity which will depend the company's ongoing development and procurement work, stakeholder

engagement on the project and the outcome of the planning consents process as well. As noted above, we are introducing an earlier stage in the process to assess the transmission owner's optioneering, closer to real time so that we can give our views on the TO's justification on the need for a project and the potential scope (e.g. sizing and technology choice) at an earlier stage of its development.

19.7 We consult on our needs case and project assessments, setting our views and the findings of our assessment and seeking the views of stakeholders. Some examples of our SWW related consultations can be found on our website (see <https://www.ofgem.gov.uk/electricity/transmission-networks/critical-investments/strategic-wider-works>). Some of the data used in our assessments cannot be published, such as specific cost estimates of equipment, because these are commercially sensitive and could potentially compromise ongoing negotiations or future procurement exercises undertaken by the companies.

19.8 No this isn't an omission. The 3.20 clause in our guidance gives an overview of the key assessment questions we consider in the final needs case assessment for SWW proposals. It should be read in conjunction with the rest of chapter three, which gives further detail of the type of information we require from the TOs to inform our assessment, including long-term value for money, NPV of different options considered, and significant environmental or social impacts that it has considered.

I hope this email provides some further clarity on the arrangements involved in the area of new transmission projects and how these also interact with more recent developments for onshore tendering and the enhanced SO role in network options assessment. If there are further questions or topics you would like to cover at our meeting in March, please let me know