



Energy and Climate Change Committee

Oral evidence: [Pre-legislative Scrutiny of the Government's Draft Legislation on Energy](#), HC 776

Tuesday 22 March 2016

[Watch the meeting](#)

Members present: Angus Brendan MacNeil (Chair); Rushanara Ali; Tom Blenkinsop; Mr Alistair Carmichael; Glyn Davies; James Heapey; Antoinette Sandbach; Julian Sturdy

Questions [104-188]

Witnesses: **Maxine Frerk**, Acting Senior Partner, Networks, Ofgem, **Rob Salter-Church**, Partner, Consumers and Competition, Ofgem, and **Steve Beel**, Partner, Competitive Networks, Ofgem, gave evidence.

Q104 Chair: Good morning, panel, and thank you for coming along. It is much appreciated. Could you state your names and organisations, please?

Rob Salter-Church: Rob Salter-Church from Ofgem.

Maxine Frerk: Maxine Frerk from Ofgem.

Steve Beel: Steve Beel from Ofgem.

Q105 Chair: Thank you very much. I would like to begin with some questions about the new powers for Ofgem to modify industry codes. EDF said there is little evidence of existing code governance arrangements limiting innovation. Why do you think new powers are needed to make code changes?

Maxine Frerk: Rob is the expert on that area and I will let him answer most of the questions but if I start off with a high-level view on that, our view is very much that these powers are needed. The sorts of changes that we are talking about here, in terms of much faster switching and half-hourly settlement, are big changes to the industry with wide ramifications. This is about Ofgem providing leadership to make those changes happen. Clearly industry have the expertise in the detail of those codes and we would have to collaborate very closely with them but what they lack, as the CMA identified in the report they published last week, is any real incentive to make those changes. These are changes

that are going to improve competition in the market, which is why the CMA was keen to see them happen. Inevitably, industry themselves do not have the incentive to drive them through.

Q106 Chair: Why are industry players large and small, from EDF to a smaller player like Utilita, feeling that these powers are unnecessary, that they are just too big a sledgehammer to crack a nut? What do you think the reasoning for that line of argument is?

Rob Salter-Church: I would say that people are focused on how we are going to exercise these powers. One of the things I maybe can do is explain the arrangements that we are putting in place to engage industry throughout the process. This is not a case of new powers for Ofgem to sit in isolation and develop code modifications. As Maxine said, industry are the experts on these new arrangements.

What these powers will enable us to do is to form an Ofgem-led but collaborative industry programme. We have, for example, on switching, more than 40 organisations across the sector engaged in an active manner. We have working groups on a weekly basis with more than 150 people from these different organisations involved in helping us shape these new arrangements, from working level all the way up to the CEO. The key area of interest from suppliers and others is to ensure that we continue to do what we are doing, which is to engage them right up front in designing these new arrangements.

Q107 Chair: RWE feel that there is not the expertise within Ofgem to do this. Their reasoning for being worried about Ofgem having these powers is that you could cause delay in projects and further developments.

Rob Salter-Church: I would agree with RWE that there is no one party that has all of the relevant expertise. What these powers enable us to do is to lead a programme that brings together the relevant expertise from industry and others to redesign these new arrangements.

Q108 Chair: You are talking about an independent body being created, a new body being created?

Rob Salter-Church: No, not a new body. What we have established is a programme structure for the switching programme, which is led by Ofgem, and all of the relevant organisations contribute to that.

Just to pick up your point about delay, the experience that we have seen on the mandation of half-hourly settlement for larger business customers makes me more nervous about not having Ofgem in the lead because of the delay. That programme, from start to finish, will take six years. There are only about 150,000 sites that will be transferred into mandatory half-hourly settlement, as opposed to the 30 million that we are considering under our programme. It took four years for industry to develop the necessary code modifications, despite Ofgem encouraging industry to try to co-ordinate across the codes, and ultimately

the implementation of those reforms will take three years longer than first envisaged. That is the kind of problem that we are trying to tackle through these powers, to make sure that we can have new arrangements in place that work for consumers as quickly as possible.

Q109 Chair: RWE says that the introduction of the half-hourly settlements and the detailed coding required will take a long time. I am hearing a number of timespans there, but they say you are moving towards removing barriers to half-hourly settlement by early 2017. How likely is that to happen? Is that timescale doable?

Rob Salter-Church: If I might just explain a little bit about both the approach that we have taken to half-hourly settlement and also the provisions that DECC have put forward, the provisions themselves, in legislation, do not mention 2017. They are powers for us for five years from the point that they are enacted.

The way we are executing our work on half-hourly settlement is in two phases. The first is removing the barriers for suppliers who wish to use the current elective arrangements. There are a number of cost barriers that we can tackle and I am confident that we can deliver that early piece of work within 2017. The second piece of work is a much bigger piece of work, where these powers will really come into their own to enable us to co-ordinate, and that is on mandating half-hourly settlement for all 30 million domestic and small domestic supply points. That is where we need to do a root-and-branch review and look at redesigning the overall settlement arrangements. That will take longer. Our plan is to be able to make a decision in 2018 on those new arrangements, and then the implementation and transition of sites into that new arrangement will take place thereafter.

Q110 Chair: Some of our witnesses seem to have a fear that Ofgem will have these powers and will be using them quite widely, more widely than for switching and settlement. Do you think the legislation should be very clear that these powers are only for switching and settlement?

Rob Salter-Church: Already the legislation is very clear that it is only for Ofgem to use these powers to introduce new, faster and more reliable switching and for half-hourly settlement reform. They are very narrow and they also have a number of important checks and balances in place that require us to consult widely with industry, with consumer representatives and with the Secretary of State before we exercise them.

Q111 Chair: A final point from me. Some of the witnesses suggest that bringing forward this implementation of switching and settlement adds to the complexity. Already the industry feels that this could compromise on delivery. Do the industry have a case there? It is difficult for you to make a call because on the one hand you are the regulator but on the other hand, as the design is developed, you are on either side of a particular point.

Rob Salter-Church: They have a fair point. There is a lot of change in the energy sector at the moment with the rollout of smart meters and with reforms on switching and settlement. What these powers will enable us to do is to co-ordinate the process and pull

together the relevant people across the industry to explore and develop the new arrangements, so that we can take time to work out when the best point is to implement these rather than trying to rush ahead.

Q112 Antoinette Sandbach: You spoke about checks and balances. It has been suggested that there is a conflict of interest, in effect, within Ofgem if you are both initiating and approving code changes. Do you agree with that criticism?

Rob Salter-Church: I do not see that there is that conflict of interest. It comes back to how we would look to exercise these powers. This is not about Ofgem sat in isolation developing modifications and pushing them through. These powers underpin us taking a leadership role, pulling together industry experts to collaboratively redesign the new arrangements, turn them into modifications and deliver those in a timely way. That is what these powers enable us to do: to be the person sat in the centre, to overcome some of the potential lack of incentives that suppliers may have to drive through these reforms and make sure that they get delivered for consumers.

Q113 Antoinette Sandbach: There has been argument from some of the bigger energy providers that the fact that the right of appeal, merits-based appeal, has been removed disadvantages them. Has that merits-based appeal right been used in the past to delay the process? You spoke about a four-year process, a six-year process. During that time, has that appeal process been used to prolong—

Rob Salter-Church: In those particular examples the appeal process has not been used in order to delay. DECC have set out in their impact assessments the justification for the particular appeal route for these powers. In my perspective, it is very important that there is an appeal route for suppliers and for others in the sector. It is a key part of the regulatory framework. In my view, because of the way that we will exercise these powers following a period of collaborative work up front, the most appropriate route is to have judicial review as opposed to CMA appeal.

I might just clarify one point. In the current arrangements it is not a universal right to appeal to the CMA. That right is only where Ofgem disagrees with the panel recommendation from the particular industry code. If there was to be an appeal that was wider than that, a universal CMA appeal in these areas, there is a risk that you could see the new arrangements and code modifications that we have developed and built by consensus being disrupted by a small minority of suppliers who might oppose those reforms. You could imagine a scenario where suppliers might not want to see new arrangements come into place that enable their customers to switch away more quickly. It is about ensuring that there is an appropriate appeal and we are striking the right balance to ensure that we are confident we can deliver these reforms in a timely way for consumers.

Q114 Antoinette Sandbach: Judicial review is a common route of appeal for other avenues in Government, particularly where it is said that the Government has acted so unreasonably that no reasonable person would have acted in that way. Are you effectively saying that energy companies should be put on a level playing field as, in effect, our constituents are in many other areas, whether it relates to housing or other issues?

Rob Salter-Church: What I am saying is that I agree with you, it is a commonly-used appeal route within the energy sector and it is the most appropriate appeal route for these powers, as DECC set out in their impact assessment.

Q115 Antoinette Sandbach: You spoke about impact assessments. The draft legislation does not require you to carry out impact assessments prior to initiating code modifications. Given that you have to carry out impact assessment for other draft proposals, why do you think that you should not have to do that in this case too?

Rob Salter-Church: As a matter of course, we would be carrying out impact assessments for these particular programmes. They are large programmes, there are a number of options and we will have to do an impact assessment. I am not convinced that this is the normal thing that would be put in place as a provision within primary legislation, given it is a matter of practice that we would be doing it anyway for these powers.

Maxine Frerk: We have an existing obligation more generally to do impact assessments where we are taking decisions that will have a significant impact. There is already an obligation on us in that area.

Q116 Mr Carmichael: Moving on to competitive tendering for transmission networks, we have had interesting evidence from yourselves, from National Grid and from the Energy Networks Association, not necessarily contradicting each other but, shall we say, having a slightly different nuance in some areas. National Grid and the Energy Networks Association suggest that prevailing market conditions and a lack of construction risk have made offshore transmission a good investment but that these benefits may not necessarily translate into onshore transmission. What would you say to that as a proposition, and by what means are you going to be assessing whether competitive tendering for onshore transmission is providing value for money?

Maxine Frerk: Shall I start again with a very high-level response and then pass it over to Steve? If you go back to the first principles about what we are trying to achieve through this legislation, it is about giving us the ability to use competition to improve value for money and to bring innovation into the onshore networks. As a point of principle, we believe that competition is the best way to secure those kinds of benefits. We have done it offshore and we have shown it brings benefits there. The powers we are getting can replicate what we do offshore. We recognise there are differences but some of those are helpful differences that mean there are more benefits to be gained by doing it onshore. There are additional complexities but our experience offshore gives us confidence that this is something that is worth doing.

Mr Carmichael: That was very high level.

Maxine Frerk: That was very high level. There will be some more detail in Steve's—

Steve Beel: Yes. We are continually analysing the benefits that come from running the offshore regime. We produced a report only last week that reviewed the most recent couple of tender rounds.

There are key areas I would pick up where there are lessons to be learned and which we are trying to apply onshore. One is about having a very clear framework within which we run the tendering process. That includes the legislative framework, the regulatory framework, the commercial framework and how we run tender processes. It is about making sure it is clear for investors and it is consistent so that investors can get confidence from what is being put before them that they can invest into that regime.

The second one is having a clear pipeline and clear programme of opportunities. Again, essentially that is what we are trying to replicate with the onshore arrangements, so that, from an investor perspective, if you are looking to invest in this sector and build your capabilities, you know that there is a long-term opportunity to engage in that sector.

Third is the competition that comes from competing in as many areas of cost as possible. This where National Grid, to an extent, are correct. We have not been able to expose construction costs to competition in the same way offshore that we want to do onshore. Our perspective would probably be that the benefits, where we take them from offshore and apply them to onshore, are an understatement of what benefits there should be. We should be able to expose a wider range of costs. As long as we have a clear framework to do that in, I think we will get the right investment to drive those costs down.

Q117 Mr Carmichael: That is still quite high level. The industry is clearly concerned that competitive tendering is going to delay the delivery of transmission assets. SP Energy Networks have told us that there will be at least nine months required to run the process. We have not heard anything from yourselves about how you are going to make up for that time. It is a substantial chunk of time. What do you have to say on that?

Steve Beel: The main thing to say about the processes is that they should not be viewed as sequential. The activity that we would need to do in terms of running a tender is a procurement process and the transmission companies themselves have to run procurement processes anyway to engage with the supply chain. Although there is clearly a period of time where we need to do something, it is not just adding time to what they are doing. This is why we are engaging with the transmission companies and with the supply chain, to make sure that we create processes that do not lead to any delays. We would agree that we will not have succeeded if we are running processes that are delaying projects. Clearly that is not what we are trying to achieve. We will need to work through those processes to make sure they deliver at the right delivery dates.

Also, it is probably worth viewing this in a slightly wider context of some of the other changes to the system operator role that we brought in as a result of the ITPR project.

National Grid will now be producing a networks option assessment that will give longer-term visibility on which projects should be taken forward. It will give the regulator and other industry participants greater visibility on which projects should be progressed and at what time. That, of itself, will also allow us to make sure those processes are aligned so that we deliver the infrastructure when we need it.

Q118 Mr Carmichael: You are not accepting the SP figure of an additional nine months?

Steve Beel: I am not sure which phase of our process the nine months relates to but clearly we do need to run a tender process and that takes time.

Mr Carmichael: What you are saying is that—

Steve Beel: We can say our programmes will not be adding nine months to the delivery dates. Certainly where we have what we would refer to as projects in flight, where there has been varying amounts of work already done, one of the considerations we will need to look at as to whether we tender those projects is any impact on timing of delivery.

Q119 Chair: I am interested in the point you made there about competition being a principle you essentially agree with. You think it is a good idea. The Oil and Gas Authority will tell us that competition in the oil sector in the North Sea has not been as good in the long run as the Norwegian model of co-operation. The example they gave was that if you are looking for a pump in their sector you might need to go to Texas to get a pump, whereas in Norway you might just need to go to the next platform because of standardisation.

The point that is relevant to this is that you are basing these changes on a principle, on an assumption. That is fine, but assume the principle and the assumption are wrong and ScottishPower are right with the nine-month problem here. What process or mechanism might there be to abandon this and go back to the previous model, which they say would be nine months quicker? Would we then be locked into a process of tendering onshore?

Steve Beel: The oil and gas comparison is interesting. For offshore wind farm developers there is a strong focus on aligning their capabilities, things like sharing vessels when they are building out new wind farms. I do not think it is necessarily that competition prevents that happening but clearly the industry needs to have the right arrangements to share capabilities and so on. That sharing should lead to benefits.

Q120 Chair: My point was that competition is not always the best way. I just gave one example. If there is a problem with competition onshore, what recourse is there to abandon that and go back to the previous model, if they are right and you start causing a nine-month delay with this change? Once we have legislated on this, we might be locked into this.

Maxine Frerk: For the first projects we are doing that are part of the T1 price control, we will be looking in each case at whether or not it is appropriate to tender that particular project. We will be looking obviously to learn the lessons as we go forwards and make sure that we are getting the benefits. As Steve said earlier, if it is clear when we look at a

particular project that it will lead to material delays we would not go ahead with tendering on that particular project. As well as the normal criteria, whether it is high-value, separable and new, we will be looking at whether it is appropriate to tender those projects in this first phase where we are looking at those in-flight projects that Steve was talking about.

Q121 Chair: That was a useful answer. If I pick you up correctly, if the competition model does not seem to work and SP Energy Networks are correct you could then almost tacitly abandon it by doing just what you have suggested.

Maxine Frerk: I would hope that we are not going to be in that space. I do not want industry starting to think that we are already planning for its demise.

Chair: Indeed. I am just investigating all scenarios here.

Maxine Frerk: What we are being given here is the power to run competitions. We are not being given an obligation to do so.

Steve Beel: The question has thrown us a bit because we are convinced this will deliver benefits, but maybe it plays into—

Q122 Chair: That could be a danger, groupthink within Ofgem. That is what we are here to challenge.

Steve Beel: I guess it plays into the debate about where the criteria should sit in the legislative framework. We have currently consulted on what we think are clear, objective criteria for which projects should be tendered, which will not sit in the primary. There is a facility for those criteria to be reviewed over time. That would also help with the particular challenge that you are talking about.

Mr Carmichael: The question is how long you let it run before you realise you have a problem or before you realise your model is not working.

Chair: Especially if such a question is throwing the assumptions within Ofgem. That is some institutional groupthink, perhaps.

Q123 James Heappey: First, I would like to ask about the early and late models and your views on that. When a panel of the industry was sat before us last week they were fairly clear that it was the early model that had the greatest potential advantages, but suggested that Ofgem and/or DECC are erring toward the late model out of risk aversion. Is that right?

Steve Beel: There are a few different things that play into this. In the short term we are looking at many projects that have already made a certain amount of progress, and so when are looking at some of those early projects it may be that it is simply not possible to run an early model because they are already far enough down the track.

In a UK context, with many similar infrastructure procurements, they do not always transfer planning risk to the party that is actually going to run that process. In terms of the familiarity of models to different types of investors and across different sectors, the late model is probably something that is more widely familiar to people. We also need to be mindful of investor appetite for different aspects. I appreciate that the onshore networks both wanted to go for the early model but in terms of a slightly wider investor perspective we would say that there is more comfort around the late model currently.

It is true to say that, in terms of, for example, innovation on different solutions to transmission challenges, the early model opens up a wider range of possibilities.

James Heappey: It does.

Steve Beel: The challenge in any circumstance—this is already the challenge we have with the existing incumbents—is that trade-off of how many different options they look at and making sure that there is still pressure on costs and so on.

Q124 James Heappey: There is a real danger, which was shared by others on the committee who have seen transmission or distribution projects being built in their constituencies. You go through the first phase of a consultation and you work out what it is you are going to do. That takes quite a lot of time. Embedded within that is the development of all the detail of the build as well. If you then, at half time, competitively tender, you effectively then have to ask others to come in, pick up the concept you have designed, crunch all the construction detail and go through a planning permission process thereafter. The detail of the build, the management of vehicles and the disruption to local communities is just as big a part and none of that detail is known until someone is coming forward to tender. For me, the late model is fundamentally flawed. From my experiences of the Hinkley Connection project down in Somerset, I cannot see how you could have done the late model without making a difficult process even more difficult.

Steve Beel: It may be some of this is project specifics and particular characteristics.

James Heappey: No, there is plenty in the Hinkley project that would be transferrable to all others. It was a major infrastructure project. The idea that at half time you say, “Right, we now know how we are going to do this and now we are going to competitively tender,” seems to me to be absolutely ridiculous. I have some very grave concerns over it, whereas the early model, the idea that you say, “We need to connect A and B. What are your ideas?” and then people tender and the winner gets to take the consultation and the planning process through, that makes sense. From what I have seen in Somerset, the late model is quite worrying.

Steve Beel: As the panel were saying last week, there is a general preference to move towards the early model and we would not necessarily disagree with that.

Q125 James Heappey: Why not just go for it and allow grandfather rights for projects you think might benefit from competitive tendering that are already in process?

Steve Beel: Having said that, the position on some of these projects now is that they still need to find the most efficient way of delivering on their planning consents.

Q126 James Heappey: I am not questioning it. You can allow grandfather rights. We should not let projects that are in the pipeline and an enthusiasm for delivering those more cheaply cloud our judgment when it comes to creating legislation that will ultimately lead to a different way of doing these projects right from the outset. Surely we should aim for the latter and then find a way of allowing grandfather rights for the ones that are already in progress.

Steve Beel: In terms of the detailed design of this, we need to consider the options. There is still a case that looking at the way that existing processes are being run is not necessarily the best basis for looking at how we might do it in the future. In the future the enhanced role of the system operator, the role that they may take in terms of planning and consenting, and a process that is designed to create that window for tendering the detail of construction still gives us the opportunity to run the late model in the way that we envisage even if there may be a push to, in as many cases as possible, deliver an early model because of the greater benefits it brings.

Q127 James Heappey: We might leave that there. Suffice to say that I disagree with you. You might need to take that up.

Maxine Frerk: I think we did. It is that point about whether we are sacrificing the ability to do some of those earlier projects entirely if we abandon—

Q128 James Heappey: No, I think there is a way of doing it. We will test the Chair's indulgence if we push this much further but I think there is a way of doing it while being bolder. If we are going to deliver competitive transmission let us do it properly, not complicate the process by introducing it late on in the planning process.

I just want to talk briefly about Ofgem's role in determining which assets are competitively tendered. Industry was concerned that the asset criteria for competitive tendering will appear only in secondary legislation. Given the Secretary of State will have to consult with Ofgem on this, how can you reassure the industry that any concerns they have will all be acknowledged?

Steve Beel: At the moment, the criteria as we envisage them are the ones we have been consulting on quite extensively previously. We talked in our ITPR conclusions back in 2014 about high-value, separable, new assets broadly forming the criteria and that is what we have continued to consult on with industry. It is fair to say there is a balance of views but a lot of prospective investors are very comfortable with that very clear framework because it gives them the clarity that they will know, looking forwards, which kinds of projects are going to come through that. There has been quite an extensive amount of consultation on those to date. The extent to which the Secretary of State redoes some of

that consultation is their decision, but clearly in their consultation with us we will share a long history of consultation around what those criteria are.

The key thing for us is that, in order to create a very clear framework, there are some very clear and objective criteria set out in terms of which projects will fall into the competitive regime and which will fall outside. That is for the benefit of both the incumbents, in terms of knowing what capital expenditure programmes they will have outside of the competitive process, and also for new investors so that they know exactly what the opportunity looks like.

Q129 James Heappey: SP Energy Networks noted that the majority of projects up for tender up until 2021 will be in Scotland, due to its lower threshold for strategic wider works. Is that fair and if not, how do you intend to address the issue?

Steve Beel: That balance comes out of the price controls that were set for RIIO-T1. Those thresholds were proposed by the companies themselves and we have made it clear for some time that strategic wider works projects would be the only projects that we would consider tendering as part of RIIO-T1. We are comfortable that that has been clear for quite some time.

Beyond that, we would see the benefits of competitive tendering being about making more projects economic. At the moment we run competitive tenders for offshore wind farms and they get the benefits of those improved economics, in a sense, widening that opportunity. If the balance is more in Scotland then it may be more Scottish projects that benefit from those better economics. We do not think it is unfair to Scottish companies. Nor do we necessarily think it is unfair in terms of the balance of where investment will be in the short term.

Q130 James Heappey: In terms of your role as the tender process manager, Ofgem will be responsible for determining which individual assets that meet the Government's high-level criteria are tendered for. When do you expect to be able to set out how suitable projects will be identified?

Steve Beel: In the longer term, this is where the "new, high-value, separable" criteria come in. The benefit of those criteria is that they are sufficiently clear and objective, we would hope, that there should not be too much judgment we are having to apply as to whether a projects falls into that basket or not. For the shorter-term projects, the projects in flight, aside from there being an assessment as to whether they meet the criteria, we have also said that we will obviously consider other aspects as to whether it is appropriate to tender those projects in the short term. Some of those aspects may relate to the timing issues people have talked about and so on.

Q131 James Heappey: National Grid has said that project-specific impact assessments are needed to ensure individual projects are correctly identified for competition. What are the

pros and cons of its idea? Presumably it is in its interest because otherwise it would not have said so.

Steve Beel: Possibly. Going back to the work that we have done on the criteria, one of the design principles for us is to create a very clear framework so that people know well in advance. When National Grid start producing the network options assessment, people will be able to foresee many years ahead which projects are going to fall into competition or outside of competition. That has informed why we would say we have taken a relatively cautious approach to the threshold that we have applied, in terms of the values of assets. That is one of the core principles for us, the best way of making this a very clear framework so that investors have the confidence of what they are looking at.

To go down the National Grid route undermines that quite fundamentally because people do not know, from one project to the next, whether it is going to come forward or whether information changes as the process develops. One minute it is in and then it is out because we have had to change our assessment. In terms of what we are trying to create as an overall framework, we do not think it works. The alternative is to forget having any criteria at all and assess every single project. I do not think it helps anybody to have that kind of continual assessment of individual projects.

Q132 James Heappey: Finally, SSE have noted that these regulations will be subject to approval only by the Secretary of State rather than Parliament. Is that robust enough?

Steve Beel: In terms of the third layer of the legislation, which relates to tender regulations and so on, we could show you the offshore tender regulations that we already have and they will be very consistent, I think, with what we will end with. It is about how we run the tender process, how we recover costs from participants and so on. It is designed to exactly mirror what we do for those offshore regulations and so in that context we think it is appropriate.

Q133 Chair: Just to take you back a little here, the transmission thresholds are £500 million for England and Wales. The Scottish Hydro Electric area is £50 million and the ScottishPower area in southern Scotland is £100 million. Why are there different levels in the threshold? I do not understand that.

Steve Beel: My understanding is that the thresholds are put forward by the companies as part of their RIIO business case submissions. Those thresholds were proposed by them as part of the settlements they were seeking to achieve under the RIIO processes. Those companies got fast-tracked and I guess that may have played into that aspect. Those thresholds were set in relation to the price control process.

Maxine Frerk: For strategic wider works, they will get allowed revenue. We will assess separately and then come back for additional money for any projects that are classified as strategic wider works. Otherwise they just have to absorb the costs within their overall revenue allowances. They picked the threshold at which they wanted to be able to come back to us to ask for more money if those projects were going ahead. We had made clear

that that was also the threshold that we would be using for deciding which projects were going to be subject to tender.

Q134 Chair: What would the effect then be if they had all gone for a £500 million threshold?

Steve Beel: We produced a list back in 2013 of potential strategic wider works projects and it is fair to say that the timing of lots of those projects is somewhat uncertain in terms of when they will actually come forward. One of them, Caithness Moray, has already been through the strategic wider works process. Both the timing and the valuations of some of those projects are a little bit uncertain. I am not sure pushing the threshold up to £500 million for everybody makes that much difference because some of the Scottish projects are also very, very large projects.

Q135 Chair: If it does not make any difference then, or much difference, why is there the difference in the figures?

Maxine Frerk: There are a number of projects.

Q136 Chair: Correct me if I am wrong here but if you are in one area and the threshold is high, and in another area the threshold is low, it is going to be easier to move to compete in one area and go for work. There would be some who can bleed over and compete in one area while they are protected from competition in their own area. Am I correct in that assumption?

Steve Beel: That is a true consequence of what they put forward as their thresholds under the price control process.

Q137 Chair: They are happy with the thresholds they have given? There is no arm-twisting behind the scenes that we cannot see or a particular set of situations that have left them with no alternative but to take these thresholds?

Maxine Frerk: No, they were the thresholds that they put forward as part of their RIIO proposals. Whether, in practice, when we look at the individual projects, they all happen or on what timescales that happen, a lot of that is going to be dependent on whether some of the offshore developments themselves go ahead. I am not sure that the number we are talking about there is going to be that different in practice. As Steve says, many of the projects in Scotland are that big they are above the £500 million threshold anyway.

Q138 Chair: Panel, a final question from me. It is about the transmission and distribution being included in this. Has the same thought been given to the inclusion of distribution on the tendering as has been given to transmission in the process of this legislation?

Maxine Frerk: It clearly has not. For transmission we have been talking about competition for a long while. It was part of the transmission price control. For distribution,

it is very clear that this is about future-proofing the legislation. We have no immediate plans to introduce competition for distribution networks and it was not part of the price control package that we agreed for ED1, but if you look further ahead it is clear that the way that the energy system is changing, it is much more important to be able to look end-to-end. The boundaries between distribution and transmission are becoming increasingly blurred. We think it is right that the legislation has that future-proofing. At some stage in the future we may want to look at distribution but we have not done anything like that consultation and we would not be doing anything in the short term in that area.

Chair: Thank you very much, panel.

Examination of Witnesses

Witnesses: **Lord Bourne of Aberystwyth**, Parliamentary Under-Secretary of State, Department of Energy and Climate Change, **John Fiennes**, Director, Energy Strategy, Networks and Markets, Department of Energy and Climate Change, and **Daron Walker**, Senior Responsible Owner, Smart Meters Programme, Department of Energy and Climate Change, gave evidence.

Q139 Chair: Can I thank the second panel for coming this morning? Your attendance is appreciated. Can we ask you to state your names and organisations, please, for the record?

Lord Bourne of Aberystwyth: Lord Bourne, Minister for Energy and Climate Change in the House of Lords.

Daron Walker: Daron Walker. I am the Senior Responsible Owner for the Smart Meters Programme.

John Fiennes: I am John Fiennes, the Director of Energy Strategy, Networks and Markets in the Department of Energy and Climate Change.

Q140 Chair: Can I bring with the issue relating to smart metering? The Department says it is necessary for the Secretary of State to continue to be able to intervene in the smart meter programme, in licensing and industry codes, to drive the timely combination of rollout of smart meters and delivery of benefits during early operations once rollout is complete at the end of 2020. The industry has significant concerns about this so we are looking for some reassurance. Can you reassure them?

Lord Bourne of Aberystwyth: About the delivery date?

Chair: Yes.

Lord Bourne of Aberystwyth: Certainly I can. I meet with Big Six suppliers on a regular basis, and indeed other suppliers beyond them, and we are firm on the 2020 date. The

rollout is proceeding at that pace. We now have more than 2 million smart meters in store and that will ramp up during the course of this year and particularly next year, so we do think it is on course. Obviously with any project of this size it does not come without risks. That is clearly the case with a national programme like this but we are alive to that and we do everything we can to address those risks as and when they arrive.

Q141 Antoinette Sandbach: There were particular concerns about the Secretary of State extending her powers beyond 2020. If you are on target, why do the powers need to be extended beyond that period, even though the industry accepted that the Secretary of State has never inappropriately used her powers to date? Is it reasonable to extend the Secretary of State's powers beyond 2020?

Lord Bourne of Aberystwyth: I think it is. If I may say so, there is a conflating of two different things there, the 2020 date and the date when we need the ability to address things that have arisen in the course of the programme. Delivery will be completed in 2020 but a year after that we undertake to review the whole programme to see how it is affected. There will be an issue like people who have refused smart meters, and we accept there will be some of those who may have changed their minds, who may want to revisit that. We will need to address things like that. There will be things that will help us progress to smart grid, like peak load shifting and so on. These are issues that will arise after 2020 so we will need to continue to have the power of the Secretary of State to keep driving the programme to make sure we get maximum benefits. Our best estimate of how long that should go on is towards the end of 2023.

Q142 Antoinette Sandbach: It is about an outcomes-based approach? The requirement for that additional period is about driving the outcomes from smart meter rather than the delivery of the smart meter rollout itself?

Lord Bourne of Aberystwyth: Yes. I think you have put it much more crisply than I did. That is true.

Q143 James Heappey: I would like to move on to some of the issues relating to switching and settlement, in particular Ofgem's powers to modify codes. EDF says the current process, involving a neutral code administrator and independent panel members, is more transparent. How do you respond?

Lord Bourne of Aberystwyth: I think the essence of the powers in the draft legislation in relation to Ofgem being able to drive the process on switching and settlement is very much to making it a more streamlined system. At the moment that process, without this legislative backing, could take two and a half years. With the short circuiting of some of that process, if I can put it that way, it will still take a year, so it is still quite a long process. Given that the Government believe and I am sure consumers do, that switching and early settlement are very good things, we don't want it to be subject to unnecessary delay, which a major code review could be. So that is what is behind the thinking.

Q144 James Heappey: A recent paper co-authored by Professor Catherine Mitchell recommended code governance be placed in the hands of a dedicated code management body rather than Ofgem so that Ofgem can concentrate on the economic regulation. How do you respond to that?

Lord Bourne of Aberystwyth: I think the Government believe that Ofgem is the appropriate body. We do not see the need for great growth of additional bodies and additional regulators. Ofgem do a very good job. We are convinced that they are the appropriate body. We do look at alternative views on that but so far as we can see they are the appropriate body for carrying this forward.

Q145 James Heappey: Given the Government's statement in last week's Budget Red Book that it wanted to ensure Ofgem could focus on its core functions of economic regulation and promoting competition, does the idea not have some merit?

Lord Bourne of Aberystwyth: It is right to say that we are trying to give more focus to what Ofgem do. E-Serve will come within the Department because we think that sort of advisory function is more appropriate for the Department but with something of this nature, given Ofgem's experience here, we believe they are the appropriate body to take this forward.

John Fiennes: Perhaps I could add one or two things to that. We had the Competition and Markets Authority come out with its provisional decision on remedies very recently and it did cover code governance in that. I think it is quite clear that they are seeing that as a system that is absolutely at the heart of how competition operates, which is why it has addressed it in its provisional decision on remedies. It thinks the current system limits innovation and it fails to keep pace, and its conclusion was that Ofgem should be given powers to take "substantive control as appropriate". It plainly sees that as the direction of travel that we should be going in for competition purposes. I think it is wrong to see the operation of the codes as something that is somehow peripheral to how the markets work. It is absolutely at the heart of how the markets work and, therefore, should be core functions of what Ofgem does.

It will always be the case, of course, addressing your point on transparency, that Ofgem will want to work very closely and very transparently with experts from industry, and this is way in which the powers are framed to enable the powers to achieve the movement that consumers need in the expectation that will unlock co-operation and work with industry while not losing out for the consumer. That is the balance we are trying to strike.

Q146 James Heappey: Let's say the argument is won and Ofgem does this, we have heard concerns that Ofgem does not have the expertise to draft and implement major code changes. Have those concerns been raised with you? If so, what do you intend to do to address those perceived shortcomings?

Lord Bourne of Aberystwyth: We will certainly be speaking to Ofgem about that but the indications that we have is that they do have the requisite expertise. I do not think there is any doubt in our minds that they do. I have heard such concerns, but I think they have the appropriate expertise.

Q147 James Heappey: Finally, just on the right of appeal, why doesn't the draft legislation provide any appeal rights to licensees or code parties over and above standard judicial review proceedings?

Lord Bourne of Aberystwyth: Of course there is an appeal to the Competition and Markets Authority in relation to any variation of licensing, but otherwise the appeal is by judicial review and we think that that is appropriate.

John Fiennes: I think you only have to read the CMA's provisional decision to see the extent to which they see the importance of Ofgem being able to make swift progress. We are trying to strike the right balance here between the right checks and balances for the parties concerned but also defending the interests of the consumers. This is something that has been well argued over through the CMA process and I think you can see where they are ending up.

Q148 Antoinette Sandbach: Do you have evidence of the Big Six using their current appeals process inappropriately?

Lord Bourne of Aberystwyth: I would hesitate to say that they would use it inappropriately. I don't think we have evidence of that.

John Fiennes: I don't think I am saying that. We would say that the experience of the significant code review has been that those move very slowly and too slowly to defend the interests of consumers adequately, and I think that is where the CMA are as well. But it is not that we are pointing to a particular instance now and saying, "That was plainly the wrong thing to do and that was a tactical move". The thing about the codes is that they are, as the previous question implied, quite extensive and quite complex. How do you know—

Q149 Antoinette Sandbach: Sorry to interrupt you. What I really want to know is are you attributing delay to the appeals process as part of that extended timeframe in terms of the code reviews?

John Fiennes: I think we are recognising that the significant code review process is overall too slow and it needs to be faster at every stage, which is why we have a set of proposals that address it in the early stages, giving Ofgem the power to intervene, and a proposal to limit it to judicial review when those code decisions have been made at the later stage.

Q150 Antoinette Sandbach: I don't see what problem you are trying to remedy though if the appeals process has not been used inappropriately and has not led to delays.

John Fiennes: I don't want to say this is what has happened but if it were the case that industry who wished to slow things up felt they could do that through the initial stages of code development, then maybe they would not need to place so much onus on the appeals process. If the early stage moves faster then it may be the latter stage become more tactically important.

Q151 Antoinette Sandbach: The draft proposals that you have brought forward empower Ofgem to enable or require half-hourly settlement. British Gas suggested before the introduction of any mandatory settlement there should be full cost benefit analysis of mandatory half-hourly settlement to understand the impact on different types of consumers. Do you agree with that?

Lord Bourne of Aberystwyth: First of all, we very much anticipate that Ofgem will be consulting with the suppliers and with other interested bodies before this is implemented, so we accept the need to do that. In terms of a full impact assessment, I think we would be expecting to see something.

John Fiennes: Our approach is do elective first with the barriers removed by early next year and then make a decision on the timing of mandatory. I don't know exactly what the plans are. We can write to you with that, but I would be extremely surprised if there was not a lot of information about why that decision was made at the time.

Q152 Antoinette Sandbach: Utilita told us that industry administration charges were a deterrent to half-hourly settlements and that if these were removed there would be less need to mandate it. Have you considered that point?

John Fiennes: I am sorry, I missed the question. Do you mind it saying it again?

Antoinette Sandbach: Utilita told us that industry administration charges were a barrier to half-hourly settlement. Have you looked at removing those because that would encourage much more half-hourly settlement? Have you considered that point?

John Fiennes: Ofgem is doing the detailed work on the barriers that need to be removed to enable elective first and subsequently mandatory. I am sure it will have had that point and is considering it, but I can't comment on it today from a DECC point of view.

Q153 Mr Carmichael: Moving on now to competitive onshore tendering and the draft legislation essentially enabling and the detail is going to come in secondary legislation. Indulge a recovering Whip here on some points on parliamentary procedure first of all. We understand you still have quite a lot of work to do on the detail of the onshore tendering regime. How are you going to be working with stakeholders to ensure that the regime is workable, efficient and clear?

Lord Bourne of Aberystwyth: First of all, you are right, there is certainly still work to do and this is in a sense enabling. We have the experience of the offshore competition, which has been successful, we feel, so we build on that. There are alternative models in terms of

how we do the sale, whether it is an early or a late model, which will need to be considered and it could be that it is a mix of those. We come to that very much open-minded but we will want to talk, obviously, with all interested parties about this. Based on the experience, we believe it will drive down costs, it will be good for consumers, so we will want to talk about the details, you are absolutely right, but this is in a sense an enabling power to enable all of that to happen and we will have the experience of the offshore.

Q154 Mr Carmichael: The evidence we had from SP Energy Networks is that the criteria for triggering competitive tenders should include more detail including “a specific pounds million value for assets”. Are you going to do this with negative resolution procedure?

Lord Bourne of Aberystwyth: I wouldn’t have thought so.

Mr Carmichael: That is what it says in your explanatory notes.

Lord Bourne of Aberystwyth: On your question about the size of assets, I think we are clear that they have to be substantial. We are thinking in terms of £100 million is the sort of figure we are looking at.

Q155 Mr Carmichael: But that is not appropriate for negative resolution. There needs to be more scrutiny than that, doesn’t there?

John Fiennes: I think it depends how you are seeing this legislation.

Mr Carmichael: We will hardly see it at all if it is negative resolution.

John Fiennes: But this is the point. We have in Ofgem an expert regulator who takes a lot of decisions about what networks are to be supported and the mechanism by which they are supported. It does that in an independent way. The DECC challenge on this, the DECC task, is to define the legislation to allow that regulator to take those decisions in a proper way. This legislation is an expression of something that I don’t think many people would disagree with, that in the right circumstances having a competitive process gets you better price discovery than elsewhere and we believe that ought to be a tool that the independent regulator should have in their armoury to be able to respond where they think that is the right thing. That is a different question from how tightly does Parliament wish to scrutinise the decisions that the independent regulator takes. Part of the point about the independent regulator is that investors know that there is not detailed ministerial and parliamentary oversight of all their decisions. That is what underpins confidence in the regime, low cost of capital and, therefore, consumer benefit. What I would say is you need to satisfy yourselves, I would suggest, that this is an appropriate tool for the regulator to have and then to think carefully about how much intervention you wish Parliament to have, recognising that it may have countered any disbenefits if it looks like we are politicising a process that has not been political up to that point.

Q156 Mr Carmichael: You set it up using negative resolution. Ofgem then go ahead and develop the details of the tendering regime and they submit these details back to the Secretary of State. It looks to an outside observer as if you are trying to cut Parliament out of this whole process.

John Fiennes: From memory—my team will doubtless correct me with a note in a moment—is that this is the process that was already agreed for the offshore regime and at that stage people—

Q157 Mr Carmichael: Do you think that just because it worked offshore it is necessary to transfer it to an onshore regime?

John Fiennes: I don't think that argument necessarily follows, but in this instance we think that it does. We think the assets are sufficiently similar and the process will be sufficiently similar to justify the same treatment.

Q158 Mr Carmichael: If you are wrong about that, how do we know about that in this building?

John Fiennes: I am sure you will wish to scrutinise the operation of the onshore regime just as you have on the offshore regime previously and we will be here answering for it.

Q159 Mr Carmichael: Would you look again at the question of the negative resolution?

Lord Bourne of Aberystwyth: Yes, bearing in mind that even on negative resolutions there are powers for both Houses to call those in. It is not as if there are no powers in relation to negative resolutions.

Q160 Mr Carmichael: Could you give us a flavour of how you think Ofgem is going to go about this work? National Grid says it is critical that all relevant stakeholders are fully engaged in the decision-making process as to whether an asset should be contested. We explored some of this with Ofgem in our earlier session. How do you expect it to engage with people to determine the details of the bidding process and this point about whether it is going to be competitively tendered or not?

Lord Bourne of Aberystwyth: Once again, we have the experience of the offshore competition to draw on. We have the fact that there has been considerable consultation, talking to industry and potential bidders, already in terms of the way this will operate, but clearly what we are looking at here is an enabling power. It is not as if this is all going to roll out very quickly. There will be time to look at this in more detail and I don't think we have any of the detailed consideration in mind as yet, I think is fair to say.

John Fiennes: I understand that you asked Ofgem earlier what would it do if it didn't want to run tenders any more. Exactly as the Minister says, this is enabling legislation that uses "may" rather than "can", so it provides a tool that Ofgem has the scope to do it where

it thinks that makes sense for the consumer and for the assets but there is not an obligation for them to do that.

Q161 Chair: I am interested in these thresholds for the strategic wider works and I note that there is £500 million for England and Wales, £100 million in one part of Scotland and £50 million in another part of Scotland. It might seem strange but as an SNP member I am a bit concerned that consumers in England might not end up getting the benefits of competition as early as the Scots are getting the benefit of this competition. Why are these thresholds different and what do you think the effect on consumers might be?

John Fiennes: I was sitting at the back when I heard you questioning Ofgem about that and I think they explained the position than I can. The thresholds were volunteered by the companies concerned in the knowledge that there may be assets to which the competitive process may be applied. The benefits to consumers are in two ways, one of which is the financial savings that may come if we have better price discovery or an innovative way of solving a transmission or a distribution problem in future. The second way in which you may get benefits is if innovation in the process or the technology applied actually provides a better service to the generators concerned.

Q162 Chair: Do you share my concerns that the good people of England and Wales might not see the benefits as quickly as the people of Scotland?

John Fiennes: I was coming on to that. The financial benefits, it seems to me, should be shareable through the transmission regime more generally. Of course then there are the innovative benefits of different technologies and if someone is able to complete a connection north of the border using a different technology and as a result the Scottish generator gets connected a little bit faster than a generator in England, that is the way the cookie crumbles.

Q163 Chair: Let's say the project is valued at £200 million. The Scottish consumer could see benefits at a level that the English consumer and Welsh consumer could be disadvantaged at under these thresholds.

John Fiennes: I think the answer to your question fits into two parts. The first part is who is seeing the financial benefit of the competition. If the consequence of the competition is that the national GB system of transmission costs are lower then it is not clear to me that that benefit is limited only to Scotland. Again, my experts will correct me if I have got that wrong. In other words, if we can drive cost out of the system wherever it is on the transmission system because of the way the regime operates then there should be a more general sharing of that benefit. That does not mean that there is not a generator in England who says, "If you had completed this asset and they had used the technology then I would have got my connection faster and that would have been better for me". That is the way that it is and that is a consequence of the different companies taking a different view of these thresholds through the RIIO process.

But in a way that would be a very nice problem to have. If this competitive process exposes a lot of new, different and better ways of building transmission assets and generators wherever they are in Great Britain bang on the day and say, “We want a slice of that”, that will be a terrific success. I am sure Ofgem will be the first to come back to us and say in that circumstance, “Can we widen this and can we apply it more generally?” We are not there yet. We think there is enough evidence to show that we should give this a good go. We think Ofgem have developed this patiently over a number of years and now is the right time to move on it, but we will cross that bridge when we come to it.

Chair: If the Ofgem assumption is correct that competition drives innovation, innovation will be driven furthest and first in Scotland if indeed that is true.

Q164 James Heappey: I do not know if this panel was in the room when I was asking the last panel about the planning issues around the early and late models. We have heard that the late CATO model for onshore competitive tendering will mean potential operators have less opportunity to innovate in design, to engage with communities and to save on costs. Why do the Government prefer the late CATO model?

Lord Bourne of Aberystwyth: I think we are neutral on this. There are advantages to the early system and there are advantages to the late system. The early system, as it suggests, probably means that some of the benefits accrue more quickly although it has to be said that we may be able to attach late models to some systems that are already up and running where you could not get the early ones. Broadly speaking, it may be that there is a delay in the benefits coming from the late one. On the other hand, with the late one it does seem to create potentially more of a level playing field. It enables people who are not the incumbents perhaps to have a longer look at this, so we feel there may be consumer benefits, but it is horses for courses. The evidence from the offshore is probably that late is working there. That does not necessarily mean that it is appropriate here and it could be a mix of the two.

John Fiennes: I think they do different things for you. If you can see you have a need you wish to meet and you do not know if the answer is a wire of one sort or a wire of a different sort, or maybe even a wire combined with a battery or something we have not even dreamt of, then the early competition is the way to do that because that maximises the innovation in the system. If you have a situation where the technical solution is pretty clear-cut, that what you are wishing to do is to see whether someone can surprise you about the efficiency with which they can put that asset in place or the way in which they can finance it, then the late model makes quite a lot of sense because the nature of the competition is more about the financing and the delivery of the thing. In different situations these could be good for consumers in different ways. You will have seen the National Infrastructure Commission’s report on smart energy recently, which explains the extent to which the power system is changing and will continue to change with technology. That is the sort of world in which the early model is particularly important because it may be that in a world of more flexible demand and more storage the old dinosaurs of big overhead lines going from big power generator to a supplier may not be

the most appropriate solution. We see allowing the prospect of early competition as being one of the enabling ways of getting new thinking into that.

Q165 James Heappey: Why constrain yourselves by plugging for the late option in this draft legislation?

John Fiennes: I don't think we do constrain ourselves.

Lord Bourne of Aberystwyth: I don't think we do.

Q166 James Heappey: So the early option is as much in your thinking right now as the late option? We are likely to see legislation come forward that means that for projects that are currently in the pipeline, so where the planning consent has already been given, the late option will be applied and there will be competition for who can build that plant the cheapest but for all other things coming forward in the future the early option will be applied and, therefore, there will be competition over concept not just construction price?

Lord Bourne of Aberystwyth: I think it is fair to say that both are in play. We are open on this. We can see advantages, as has been indicated, from both systems according to the circumstances. We wish very much to keep open that element of any—

Q167 James Heappey: I am sorry but I was quite specific in my question. There is a late model for those projects that are already in the pipeline, which I understand was a consideration, but that for any projects that have not yet started out there will be an early model applied and there will be competition over concept not just competition over construction costs?

Lord Bourne of Aberystwyth: When you say early model applied, I think it is open for an early model.

John Fiennes: Subject to parliamentary time. Of course, we don't know when these clauses will be included in any Queen's speech. We expect to bring proposed legislation that will allow Ofgem to adopt the appropriate, the best answer for the consumer in the particular circumstance. I would not expect it to be sufficiently firm to say it is early model in all these circumstances and late in those circumstances.

Q168 James Heappey: Why not?

John Fiennes: Well, because we do not believe in tying the regulator's hands. It is an independent body, best placed to take those decisions.

Q169 James Heappey: What would Ofgem's riding instructions be for choosing in which circumstances to apply the early model and which circumstances to apply the late model?

Lord Bourne of Aberystwyth: They have to consider elements like the benefits of innovation and benefits to the consumer, but I think it is going to be much more on a case-by-case basis than the generalised position that you are suggesting, that it is 90% one and 10% the other. I think we are looking at it being more flexible than that.

Q170 James Heappey: Can you reassure that the application of the competition over concept, the early model, will have just as much in mind the visual impact and the impact on the environment of certain transmission systems over others. My experience, as you heard earlier on, is the Hinkley project and what worried me is when you said where there is a clear technological solution. In National Grid's view there was only ever one solution for that connection project, which was overhead. I would like to see a competitive process that yields both a saving to the consumer through making the planning and construction costs cheaper but also a competition over concept so that we can deliver transmission in a way that is less environmentally damaging, wherever possible, also.

Lord Bourne of Aberystwyth: Just as on Hinkley, we do not override the planning legislation. That would be a relevant consideration for planning purposes.

Q171 James Heappey: We are talking about what comes in the future and your ability to facilitate, to learn from mistakes at Hinkley and other projects besides. There is a danger that unless it is made clear that there should be competition over concept, the easy technological solution, which is overhead, will be taken more often than not. There is a real opportunity here to achieve both savings for the consumer and a change in the way we do transmission. I suspect it needs a lead from Government through legislation rather than just leaving it to Ofgem.

Lord Bourne of Aberystwyth: With respect, isn't that a consideration for planning law? I don't accept that we did make a mistake in relation to planning on Hinkley, but if there are considerations like that it opens up a whole new area of planning law. It isn't specific to this issue of an early and late model.

John Fiennes: I would make three observations in response to your question. The first is that whatever solution people come up with will need to comply with planning law in the normal way, and so the protections will apply. The second observation is I believe you are right to say that having the potential for an early model of competition can help to widen the range of things that are considered, some of which may be more acceptable in planning terms and for local communities than others, and that is a relevant consideration. The third observation is that we know or we can see that the early model may advantage the incumbent providers in this market more than new entrants. Particularly if an incumbent is able to deploy its engineering and history here you may find that the early model of competition does not meet the hopes that we may have for it. Suppose in five years' time we have this legislation. We have had one or two bids for the early model but the power of the incumbents has shown that it is incredibly hard to make that stick. At that stage is it possible that Ofgem will be saying, "Here is an asset that, although I would have liked to do it through the early model, I am not convinced there will be sufficiently strong competition from the incumbents and it is better for consumers to adopt the late model of

competition so we can at least drive out a competitive benchmark for the financing and delivery costs of these assets that, by the way, we can then apply to all the other assets onshore”? It is not impossible. I hope we don’t end up there. I hope that if we have early competition there will be this vibrancy. I suspect there will be but it is not impossible and we certainly would not want to write into the law something that makes it so rigid.

Q172 James Heappey: Siemens, for example, were chomping at the bit to be able to bid on the Hinkley project. They felt very much that National Grid were overstating the costs of going another way and they felt that they would have been able to do it better and in a cost effective way. My instinct is that what we may see is that other utility providers elsewhere in Europe will come forward with different concepts and different costs, but I am keen that this legislation fully harnesses that opportunity rather than stopping short and allowing the bailout of the late option because it is the more risk averse.

Lord Bourne of Aberystwyth: I think the points are well made. I would come back to the very basic point that this is an enabling power and there is an awful lot of work to do before it is made good, but the points are well made.

Q173 James Heappey: On the risk of delays to projects, stakeholders have raised concerns about potential delays of up to 24 months in projects caused by the introduction of competitive tendering. Will it be possible to mitigate delays by running the planning and tendering processes in parallel? What if one impacts on the other?

Lord Bourne of Aberystwyth: First of all, we have obviously seen these concerns. We do not accept that there will be this sort of delay. We would anticipate that this is streamlined. I can’t see why the two could not run together, to be honest. I don’t think there is any potential hazard there.

John Fiennes: I think that is right. We believe there is scope for parallel processing on the development consent order. We think there is scope for parallel processing on the supply chain engagement that you need to do for these last projects as well. Of course, there is also the test in which you are putting confidence in Ofgem that they will pick assets for which this is a sensible way forward. They have certainly been clear to us that they are not going to be picking assets where this is going to introduce massive new delay in a way that is going to cause problems. It is partly in the selection of projects and it is partly in working with the bidders or, if it is the late model, the person who is doing the early development in order to make sure it is as streamlined as it can be. We hope that with innovation and new ways of doing things we may also be able to shave some time off the delivery of these projects as well if we get those right. The wonderful thing about auctions and competitions is that you don’t know until you have tested it what people are going to be able to do, and that is really at the heart of the policy that we are proposing.

Q174 James Heappey: Projects that are already up and running and a connection date is set are excluded from this?

Lord Bourne of Aberystwyth: Yes, that is right. We hope to get this moving 2017, I think, in relation to transmission but in regard to those projects on distribution that are already up and running, clearly we will not want to affect those and will not affect those.

Q175 James Heappey: Witnesses have suggested that the legislation does not sit well with the planning regime in Scotland as it is going to be more difficult under that system to amend planning orders once granted. Do you agree that the draft legislation needs to be amended to ensure any potential negative impacts on Scotland, such as delays to a project, are avoided?

Lord Bourne of Aberystwyth: We are aware of the potential for the different legal systems operating in different ways. Officials are already talking to Scottish officials about how this will pan out, so we are keeping a watching brief on that. It is nothing that can't be fairly readily overcome, I think, but of course the legal systems are different and have been for a long while, so we are conscious of that. As I say, officials are working together to iron out any potential problems.

Chair: Talking about the Scottish legal system, a former practitioner Alistair Carmichael.

Q176 Mr Carmichael: Not just a recovering Whip but a recovering lawyer as well. There is a lot of recovery to be done. I would like to look at the scope of competitive tendering and in particular the extension of competition to distribution. We have heard quite a number of witnesses giving evidence expressing, shall we say, a degree of surprise at the inclusion of distribution in the proposals for competitive tendering. Is this just future proofing?

Lord Bourne of Aberystwyth: We certainly are future proofing this. I come back to the point that on the distribution we will not be affecting existing arrangements so the timescale is obviously different from the transmission, but we are working through on the details to make sure that it is sound. It is very much future proofing to have it there in the legislation. We would have to follow up with more legislation.

John Fiennes: Exactly the same arguments apply as a matter of principle. Some distribution assets are extremely high value. As I mentioned, the National Infrastructure Commission has underlined the extent to which the distribution power system will change with demand-side response and storage. Therefore, we think that is a really interesting area for the innovation that we have been talking about. The current distribution settlement runs to 2023. We would definitely engage with industry, as Ofgem would, before we did any of this and there will be a control point for Parliament at the time when regs will be laid about those things. From the general point of principle, the notion that should the regulator have the ability to tender large, separable, high value assets in order to drive innovation and improve the benefit for the consumer, we think the answer is yes.

Q177 Mr Carmichael: The problem comes exactly from the very point that you just touched on there. It is when you are future proofing in 2016 with a control mechanism that is designed to last until 2023, the RIIO-ED1 I think—this may be a question more for the

Minister—can you confirm that there would not be a competitive tendering process for distribution while that price control period is still there?

Lord Bourne of Aberystwyth: Yes, we can. That is very much our judgment.

Q178 Mr Carmichael: There would also be a new impact assessment for the provisions on the distribution were they to be initiated?

Lord Bourne of Aberystwyth: I think that is reasonable. I don't think we have actually said that but I can say that now.

Mr Carmichael: It is difficult to see how you would survive a JR if you didn't.

Lord Bourne of Aberystwyth: I think that is a very fair question and I hope a fair answer: we would do that.

Q179 Mr Carmichael: On the question of allowing generation companies to develop transmission links, it has been suggested to us that enabling generators to develop transmission links as part of a wider network could lead to adverse impacts on other generators. What view do you take of that? Can you tell us why that was not included in the impact assessment?

John Fiennes: We believe there is value in having a full range of tools for Ofgem, but this is an area where we are keen to get views from industry through the process that you are undertaking and we will be thinking very carefully about the points that they have made. I think we are more open-minded on this than on other points. The impact assessment is an interesting endeavour because, of course, we are trying to take a sense of how much competition of what sort might be made at points in the future and it goes from zero up to a lot, and we have illustrated all that. If people feel that having a generator temporarily owning this transmission is a serious problem for competition then of course we would factor that into the final decisions that we make. I personally think that is hard to see. It is not as if the generator owns this asset and will be able to push other generators off the asset that they own, for example. My guess is this will be a positive asset that—

Q180 Mr Carmichael: You say that, but we have had evidence from Spain, from National Grid, from SSE, all in their own different ways expressing concerns about this. It is not fanciful, is it?

John Fiennes: What I would be really interested in is a pure generator worried about what the consequence would be if there was a generator build option elsewhere. You need to ask yourself when these comments are made, are they being made from SSE as a generator or are they thinking about other elements of this problem. This is an area where we are very interested in the views that come out and I am not going to say where we are going to end up in the light of the comments that have been made to you.

Q181 Mr Carmichael: You are still some way from having a coherent strategy on the use of competitive on distribution, aren't you? I can see lots of tactical uses of it here and there but an overall strategy?

Lord Bourne of Aberystwyth: We are certainly some way from that on distribution because, as we have said, we have the price control period. It is interesting that if this law were put in place what that would do to the behaviour of the distribution companies. They would probably know that competition was coming and maybe that will mean we could move more swiftly once this distribution price control is over. For the transmission elements, we think we have a pretty good model on the offshore side. By the time this Bill comes before the House, parliamentary time permitting, I would have thought we will have made more progress on that, but we think we have a good model that we are seeking to develop. As you say, there are some points of detail where we are very interested in the views of this process.

Q182 Mr Carmichael: How many years in the last 10 have we not had an energy Bill in a Queen's speech or at some point in the session?

Lord Bourne of Aberystwyth: I have not been here for 10 years in post so I wouldn't know.

Q183 Mr Carmichael: I struggle to think of any, seriously. It is all very well to say you are future proofing and you do not know when you will get parliamentary time. You have never struggled for getting parliamentary time in the past.

Lord Bourne of Aberystwyth: I am not sure that would necessarily be true. First of all, we don't know that it will be this session and we don't know it will be in an energy Bill. It does seem to make sense to us. I am sure we would have been attacked from the other side if having done this in a Bill, let's say it does happen in the coming session, we then came back a couple of years later and tried another one on distribution assets. You probably would be here saying, "Why on earth didn't you do this two years ago?" It is future proofing. We have the time to look at it. There are points that obviously need addressing but with regard to the general principle of competition and opening the market up and the benefits for innovation and consumers, we are convinced that it is the right thing. But there is still work to do, that is certainly true.

Q184 Antoinette Sandbach: Minister, can I come in on particular problems in relation to rural consumers? Very often their access to those competitive offers is limited because they are off grid, effectively, in terms of gas. They can't access dual fuel deals. If DNOs are imposing high connection costs for alternate technologies, particularly renewables then they are in effect facing a penalty in trying to adopt that technology. The current RIIO-ED1 price period locks in that unfairness. In terms of the overall strategy in approaching 2023, will there be an approach that looks at the particular problems facing rural areas. It seems inherently unfair that those who can't access the cheapest deals in effect face a double whammy in terms of connection costs from the DNOs.

Lord Bourne of Aberystwyth: A couple of points, if I may. First of all, on a more general point well beyond the Bill, we have indicated, as Government, that we are going to be looking to rebalance the costs of gas and electricity over time, and that will particularly help rural consumers who are off gas grid. I think that is good news. We are well aware of the problems for many rural consumers, particularly deep rural who are off gas grid, getting some of the benefits. It is the sort of thing that we would want to look at in the run-up to 2023 to see how we design that. Having said that, the Chairman indicated how Scotland may be getting benefit and a lot of those parts are deeply rural, just as they are in parts of Wales and England.

Q185 Antoinette Sandbach: It may be something that needs to be looked at in terms of a single connection cost, whether you are in an urban area or a rural area, in order to minimise that inequality.

John Fiennes: I was going to add to what the Minister said. Of course, things cost what they cost, to some degree. If there is an urban or a rural area where a connection involves a very large new asset then that will mean it will be more costly for the person who wishes to connect. That is not a purely rural issue. There are places where the network is pretty full in urban areas where people are saying, “I would like to have a full connection but I am facing a higher cost”. Why do we do that? We do that because having an economic signal in the system ensures that capacity is used efficiently on the network where it can be and that people only invest facing the full costs as far as possible. Overall we think that is better for the consumer. The same debate happens on should we have a postage stamp system for transmission charging. The answer is we can see the arguments for fairness but equally we can see the arguments for low cost for the consumer, which involves having price signals in the connections, and there you have it.

Q186 Antoinette Sandbach: But in effect you are entrenching the inequality that exists, particularly in rural areas where transmission networks are, by definition, more remote.

Lord Bourne of Aberystwyth: I am not sure I would go quite so far as has been suggested that we would not need to consider the interests of rural consumers. I am sure that will be something that will be taken account of. It is right to say that there is a general benefit to consumers across the piece that will be felt in rural areas as well as urban, but we do need to ensure that we take this forward in a way that is fair to everybody in the country. There are clearly parts of the country that are off gas grid and we need to see how we do take measures that will help them.

Q187 Chair: A final question from me to this panel. We are scrutinising pre-legislation here and I wanted to see how likely it is you could add further bits to the Bill, maybe a further amendment on storage. As we know, storage is something that is suffering by the power of the pen at the moment, because storage pays to store and then it pays when that power leaves storage as well. Storage needs to become a new asset class, not treated as generation or as something that it is not. How likely is it that the pen might move to enable storage to perhaps start to fulfil some of the potential that some of its proponents say it could fill and it is only

held back by red tape or the lack of movement of a pen? I would imagine you would be sympathetic to that, particularly with future proofing in mind.

Lord Bourne of Aberystwyth: Yes. First of all, thanks for the general point about stuff that is not in here and I perhaps should mention before I come to the specific, Chair, that there is going to be something that is relevant to DECC in a Cabinet Office bid for legislation on data sharing, which is not here because it is Cabinet-led. This is in relation to fuel poverty, which I think we touched on last time. For the sake of completeness, I should set that out there as being part of a much larger Bill but it is something that we very much welcome.

In relation to storage, if we are talking battery storage here, this is something clearly of great significance. The Department is working very hard on this across Government, with DfT in particular; it has issues. We are aware of the potential. It is not oven-ready for legislation yet but it is something that we are working up. Within this Parliament certainly, and I hope earlier rather than later, we will be doing something on this.

Q188 Chair: I think the argument is that you should only pay once for storage, which on the face of it seems quite logical to many people. It does not seem very complicated, to me.

Lord Bourne of Aberystwyth: No. That is just one aspect of it, I think, and it links in with smart grids and so on. I think we perhaps want something a bit wider than that. I take that point, but I think there are quite a lot of things we could be doing on storage. We are looking at those with a view to bringing something forward but, as I say, not for the next session.

Chair: Does anyone in the panel have any further questions or can we end this panel now? Thank you, panel, for coming along. I believe we have another panel that some will be remaining on and some will be leaving on. Thank you for the moment.



HOUSE OF COMMONS