SCOTTISHPOWER
RENEWABLES

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Dear Sam,

OFFSHORE ELECTRICITY TRANSMISSION: CONSULTATION on the ENDURING REGIME

Thank you for the opportunity to respond to this consultation of 18 December 2009. I am pleased to submit this response on behalf of ScottishPower Renewable Energy Ltd. We have set out our general comments and observations below, followed by responses to the specific questions raised in the consultation in the attached Annex.

ScottishPower Renewables (SPR) supports and endorses the overall aims of the OFTO tendering arrangements and regime. Consistent with the rest of the industry and stakeholders we firmly believe that timely, cost effective and reliable provision of the offshore and onshore grid assets is critical to achievement of the UK's ambitious renewable energy commitments.

It is important now that the industry and stakeholders work together to finalise the arrangements and implement them in such that they deliver their objectives of providing cost effective grid connections to enable offshore renewable projects to proceed.

We remain concerned that certain aspects of the enduring arrangements as proposed present critical risks that threaten delivery of offshore generation projects, such that many projects are unlikely to be successful. Key amongst these are:

- ✓ Ensuring the Enduring arrangements are implemented as soon as possible during 2010;
- ✓ Generator led – meeting generators' requirements should be a key criteria of the arrangements;
- ✓ Generators need certainty on capacity, programme and costs as early as possible;
- ✓ Generators should be able to decide on an early, late or very late OFTO appointment to suit their project needs;
- ✓ Flexibility should be built-in – "one size fits all" will not work;
- ✓ Ofgem are managing the tender process and should develop the detail such that it supports timely delivery of projects;
- ✓ The arrangements should be kept under review and further refined in light of experience.

Delivering the Enduring arrangements

To deliver key projects in line with Government renewables energy targets, it is critical that Enduring arrangements, in some form, are implemented as a priority and as soon as possible in 2010. This is particularly relevant to Scottish Territorial Waters sites where the SEA and Lease process means that early commencement of the enduring arrangements will be critical to their progress. Without this commitment, industry – including the supply chain – will have no confidence in the ability of the OFTO regime to deliver against project objectives. Lack of confidence in the arrangements will cause the supply chain investment to stall, with significantly adverse long-term implications for the UK.

Meeting generators' needs

In refining arrangements we believe it is important to maintain a focus on their real purpose ie to support the achievement of the UK's renewable energy targets through the delivery of cost effective, timely and reliable connections to the market. The arrangements should therefore be aimed primarily at meeting generators' needs and recognition of the generators' needs should be a key feature of the arrangements. We are concerned that many aspects of the current proposals shift the emphasis away from the generators' needs and are aimed at facilitating competition rather than new connections for projects, and making the arrangements more acceptable to OFTO bidders. Whilst we understand the need to attract and involve credible, able and experienced bidders in the process, without the generators having confidence that the arrangements will meet their needs, these critical projects are unlikely to be successful.

Ensuring certainty

To allow projects to secure the required significant levels of investment, and accounting for lead times of turbines and other supply items, generators need certainty on capacity, programme and costs as early as possible in the process. We believe the tender process should be developed and managed to achieve this and to do so will require:

- ✓ greater generator involvement in the process than is currently proposed, and
- ✓ increased focus on selecting the successful bidder as early as possible in the process.

We suggest that this could be achieved by allowing all qualified bidders to submit initial bids based on high level designs and transparent revenue streams against the generator's specified requirements. and then moving quickly to a preferred and reserve bidder 'best and final offer' stage, during which the design and revenue streams can be firmed up. We believe this will streamline and accelerate the process and ease the workload on the supply chain. We discuss this further in our answers to chapter 5.

Early or late OFTO appointment

Section 2.6 of the consultation states that continuing the transitional arrangements on an enduring basis is not within the scope of the consultation as Government policy has already discounted this approach. We believe that this decision should be revisited in light of:

- experience of the initial transitional tender round;
- the perception of bidders' appetites for assuming construction risk, and
- the supply chain stagnation impact of continued uncertainty on the effectiveness of the enduring arrangements.

We are concerned that, especially for the early enduring tender rounds, it will not be possible to attract sufficient bidders of sufficient experience, financial strength and ability to deliver the required assets, despite the proposed shifts in the emphasis of the tender process.

In addition, to facilitate an early OFTO appointment to avoid project delays, the generator may have to populate the data room with high level design specifications. Whilst this flexibility may be attractive to some bidders, it may also deter others from bidding. It is also likely to result in bids being submitted

that are not fully aligned with the generator's needs and/or that Ofgem may determine are uneconomic.

We believe that offshore generation project developers are as capable of constructing offshore assets as many of the potential OFTOs. Further, delivering the grid assets in conjunction with construction of the windfarm may realise benefits (eg reduced costs through economies of scale, programme alignment etc) that may not be realised by an independent OFTO.

We are also concerned that until the enduring arrangements start to deliver new projects the key elements of the supply chain (such as cable and switchgear suppliers) will experience a significant delay. This will mean no contracts for cable supply are let until OFTOs are appointed under the enduring regime making it extremely difficult for key suppliers to make investment decisions to support their expansion plans in the UK. As a result of the delay in establishing the supply chain the market is likely to see longer procurement and construction processes for grid assets once OFTOs are appointed than need otherwise be the case. This does not meet Ofgem's stated objectives for the OFTO process.

As a result, we believe there is a strong case for developing the enduring arrangements to allow the generator to choose a 'very late (super thin) OFTO appointment' - such that generators may choose whether to build their own offshore grid assets for adoption by the selected OFTO - or to opt for an early (thick) OFTO appointment as set out in the proposed enduring arrangements. This would allow generators to progress their projects with sufficient confidence about the delivery of the offshore assets to meet their needs.

Implementing this arrangement will widen user choice by giving the generator greater control over the delivery of their project. In addition, we believe it is consistent with Ofgem's aims of encouraging user choice.

Flexibility

Generators' requirements are likely to vary from project to project and therefore we do not believe that a 'one size fits all' approach is appropriate. Sufficient flexibility should be built in to the arrangements to allow them to be adapted as required to suit individual project's needs.

Managing the Tender Process

Ofgem are responsible for managing the tender programme efficiently and for ensuring it delivers against its purpose. Accordingly, we believe that provided the generator has sufficient input and influence in the key areas of programme, specification, capacity and cost, much of the detail of the tender programme should be left to Ofgem to develop, implement, keep under review and refine.

Refining the arrangements

We also strongly welcome Ofgem's decision to respond to earlier industry feedback by conducting this further consultation on refining the proposed arrangements in light of the very valuable experience being gained during the first Transitional tender round. We believe that this refinement should continue beyond this consultation and during subsequent tender rounds, as all stakeholders gain further experience from each successive tender round. However, we recognise the critical importance to generators and OFTO bidders of having a high degree of certainty and transparency in the arrangements and so we support Ofgem's current approach of refinement rather than reform. However, the arrangements should be kept under regular review to make sure they continue to be fit for purpose.

Other Issues

There are a number of issues that have been raised consistently in the past but, as yet, Ofgem do not appear to have addressed some of them. These include:

i. The treatment of responsibilities, costs and liabilities of decommissioning offshore grid assets;
ii. Payment for the provision of reactive power services to the OFTO and/or TSO by the generator and
iii. Clarity and certainty on OFTO revenue re-openers and consideration of the implications for generators.

These issues have been identified by industry as presenting risks to the delivery of projects and we ask Ofgem to take forward proposals to resolve them or to explain why they do not believe this is required.

We recognise the potential for conflict between implementing the enduring arrangements as quickly as possible and proposing that further refinement is required. This emphasises the need for Ofgem to take urgent action to pave the way for implementation of those parts of the process that are not subject to refinement, to give the industry confidence that the arrangements will be implemented as soon as possible this year. In addition, we recommend that at the same time Ofgem develops and implements a short, focused programme of work streams - involving representatives of all key stakeholder areas - to develop the proposals for the aspects that need further refinement.

We hope our responses and comments are helpful and we would be very happy to meet you to discuss them further. If you need further clarification on any aspect of our response or would like to arrange a meeting please let me know.

Yours sincerely,

Allan Kelly
Regulatory Policy Manager
ScottishPower Renewables

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SCOTTISHPOWER RENEWABLES

ANNEX to RESPONSE on

OFFSHORE ELECTRICITY TRANSMISSION:

CONSULTATION ON THE ENDURING REGIME

Chapter 3: Connection Application process

Although there are no questions raised on this section we offer the following comments on the proposed approach:

Generator input

The generator's ability to influence the connection proposal is very limited and we believe this will undermine confidence in the arrangements. As proposed, the OFTO, NGET and Ofgem all have greater influence over the outcome of a tender round than the generator has, yet the generator is exposed significantly to the costs and risks of the connection in addition to its project's wider costs and risks. We believe that this balance should be re-addressed, by allowing the generator greater influence in the tender process.

Under the proposed arrangements, the generator will not be aware of final decisions made by others that affect his requirements until NGET issue the Agreement to Vary, by which time the generator will only have 3 months to assess the acceptability of these decisions, and to try to secure a more acceptable position of necessary.

Financial Security

There is still considerable uncertainty over the financial security mechanism to be adopted, particularly in respect of the offshore assets. As was evident in the onshore grid queue 'Final Sums Liabilities' proved to be a considerable barrier to generator entry given the level of potential costs faced by a generator. We recognise that the costs involved in the offshore process will be significant but directly exposing generators to such liabilities will hinder overall development and progress against the renewable energy targets.

However, we recognise that applying the Interim Generic User Commitment Methodology (IGUM) is not without problems. These problems arise due to the likely scale of the offshore tariffs that will be incorporated in the calculation of the potential liability, and the tariffs not being known until late in the OFTO tender process. Both of these aspects will result in considerable uncertainty and risk to the generator. The site selection and award process gone through to secure offshore sites, and the scale of the projects, mean that, unlike earlier onshore experience, all developers entering the tender process will be taking forward their projects seriously and aggressively. As a result, it is likely that planning risk will be the key uncertainty faced by these projects – which is largely outwith the developers' control. Accordingly, we believe that securing the grid asset costs is a risk that should be partly, at least, socialised to a greater extent than in either of the security methodologies currently in use.

In addition, requiring significant security sums at very early stages of a project is likely to encourage generators to adopt a phased application approach. This is unlikely to be optimal as it will not allow a co-ordinated and integrated approach to providing the grid assets.

In addition, the generator should have flexibility to choose the methodology to be applied and to change between them once in the tender process.

Chapter 4: Triggering the Tender

1. ***Do you agree with the proposed approach to initiating the tender process?***

   Meeting the generator's requirements – particularly in respect of connection date – should be a key driver of the tender arrangements. The tender process is being managed by Ofgem with support from NGET. Therefore, we believe that either Ofgem or NGET – we favour NGET – is best placed to trigger the tender process to meet the generator's connection date requirements, which should be the key driver of this consideration especially as this will be a milestone to be met by the generator under the Lease with the Crown Estate. However, the tender process should only be triggered with the prior agreement of the generator and only once the generator has met the tender entry criteria.

2. ***Should there be an earliest or latest point (relative to the connection agreement held by the generator) at which the generator should be required to request an OFTO appointment and when should that be?***

   As stated above, we believe that NGET (or Ofgem) are better placed to decide when to trigger the tender process to meet the generator's needs. Therefore, we do not see any need to set either an earliest or latest request stage.

3. ***Do you agree with the proposed amendments to the qualifying project pre-conditions and tender entry conditions for the enduring regime?***

   We welcome any moves to streamline, simplify and accelerate the tender process. In general terms the changes appear to be much more onerous on the generator but, given the limited experience that has been gathered to date of the practicality and effectiveness of the tender arrangements, it is difficult to assess whether the proposed changes will be any more or less effective - or impose any more significant a burden on the generator - than the original arrangements.

   We would also point out that it is not appropriate to make obtaining a Crown Estate Lease a qualifying criteria but suggest that this should be obtaining a Crown Estate Agreement to Lease.

4. ***Do you have views on the time of year at which a tender window should be held?***

   As stated above, we believe that NGET (or Ofgem) are better placed to decide when to trigger the tender process to meet the generator's needs (which should include the required connection date to meet Lease obligations and reflect the practicalities of seasonal offshore working). We believe however that there will be benefits in holding more frequent tender rounds - either quarterly or more frequently on an ad hoc basis to suit the specific circumstances at that time. Ofgem/NGET should agree who has met the tender entry criteria and thereafter manage the process accordingly. We believe this will maximise efficiency and competitive benefits and also spread the workload of Ofgem, NGET and the supply chain and therefore allow individual tender rounds to be condensed.

5. ***Do you have views on the best method of dealing with contingency costs?***

   Contingency arrangements are best assessed on a project by project basis as individual projects' requirements will be different. For this reason, it is difficult to comment on the approach to the contingency arrangements without full knowledge of the terms and conditions under which OFTO contracts will be placed and without generator involvement in the evaluation and negotiation process.

   Generators need high degrees of certainty over costs as early possible in the process. The obvious way to ensure this is to avoid having bids that include contingency. However, we recognise that offshore construction requires contingency for the 'unknowns' (eg weather, ground conditions and the difficulties with aligning multi contracts) and not allowing contingency pricing will result in significant risk premiums being applied by the bidders – this is undesirable. Therefore, a

more realistic approach should be adopted, whereby some agreed level of contingency on specific items is allowed. This should be determined – by Ofgem and the generator - on a project specific basis although we recognise the potential for this to add further time and complexity to the tender process. However, we suggest that there are ways to condense the overall tender process (see our general comments 'Ensuring certainty' and answer to question 4) that should offset this.

As a simpler, fallback position allowing up to 10% of capex as a contingency could be a reasonable level of contingency provided there is no double counting of risk and the overall capex figure is efficient, accurate and reasonable. Again, the level of the cap should be agreed by the generator at the start of the tender process.

6. ***What is your view on the capping of the contingency and any associated incentives?***

See our answer to question 5 but we would comment further that the process for agreeing contingency provision on a project by project basis, and for evaluating the level of contingency should be simple and transparent.

7. ***Which items do you consider should be defined as pre-construction costs (and why)?***

Regardless of the timing of the appointment of the OFTO, there will be occasions when it is appropriate – perhaps even necessary – for the generator to have incurred – and perhaps to continue to incur after the appointment of the OFTO – pre-construction costs in the interests of advancing the project. For example, in the interest of expediting the project by carrying out critical work during a seasonal window (thus potentially avoiding 12 months' delay in delivering the project), it may be appropriate for the generator to instruct and manage survey work prior to mobilisation of the selected OFTO. It is not clear that these costs will be recoverable by the generator. In addition, regardless of a sound case for doing so, given the degree of flexibility that the currently proposed arrangements afford the OFTO there is a significant risk of stranded generator investment. Therefore, we believe that it is appropriate that the generator should be able to recover any and all efficiently incurred grid related development costs from the successful OFTO.

Ofgem should also take a commercially pragmatic view in considering how the 'efficiently incurred' test will be applied. In many cases, the supply chain lacks a depth of choice for generators: imposing a requirement that they must competitively tender all pre-construction works is not a sensible solution in terms of delivering any real benefit or savings to generators. We would appreciate clarification of how Ofgem will apply this test.

8. ***Do you consider that an Ofgem defined, standard pre-construction works transfer agreement is the appropriate vehicle for managing the transfer and payment of pre-construction costs?***

We believe it is essential that there is a framework that sets out the terms, conditions and liabilities involved in transferring pre-construction works. Typical terms should address how and to what extent liabilities associated with the works are transferred; commitments required under the agreement (eg how the pre-construction works will be used, to who's benefit and their value etc) and obligations on the OFTO to accept the works.

Chapter 5: The Scope of the Tender

9. Do you agree that the tender specification should be based on the connection application, with information also being provided relating to any pre-construction works undertaken?

Yes. The tender specification should be led by generators' needs as the generator is potentially exposed to all costs, including direct exposure if the generator chooses to exercise user choice in any respect. The generator's specification should be as 'tight' (eg capacity, programme, cable route, redundancy, availability levels, losses etc) or as 'loose' (eg capacity) as the generator chooses.

However, as stated in our general comments, we have doubts over how feasible it will be for bidders to be able to provide firm bids at this stage – the supply chain is unlikely to be able or willing to provide firm designs and costs for each OFTO's bid. Therefore, we suggest there is merit in refining the process (along the lines of that used in public/private financed capital projects) such that qualified bidders at least submit a compliant, high level, open book bid that will allow Ofgem to select 2 preferred bidders early in the process. These bidders can then refine their bids as part of a 'BAFO' process allowing Ofgem to evaluate and select the successful bid.

10. Do you agree that bidders should be given flexibility to respond to this specification as they see fit?

No. As stated above, the generator is exposed to all costs and has to provide significant financial security to cover these liabilities. Therefore bidders should tender based on meeting the criteria set out by the generator in the connection application (ie. a compliant bid). Without this provision it is feasible that bids could be received that have no relevance to the generator's needs and could expose the generator's project to significant, uncertain costs and risks. Ofgem aim to avoid imposing such costs and risk on the OFTO that might arise from bidding against a generator led specification. It is unrealistic and unreasonable to expect the generator to accept exposure to such costs and risks, especially when the bid may not even reflect their needs. To encourage innovation (although we have doubts over where such innovation could arise especially until experience is developed) bidders should be able to submit an additional non-compliant bid only as a supplementary option to a fully compliant bid. In this case, acceptance of a variant bid should only be done with the generator's agreement or at no additional costs or risk to the generator.

11. Do you agree with our suggestion not to incorporate capacity over sizing into the enduring regime (unless financial commitment is provided for that capacity)?

Yes. Bids should be based on the generator's connection application (including required capacity). If a bidder chooses to offer additional capacity, unless there is an agreed benefit to the generator, then the generator should not be exposed to such additional capacity.

Chapter 6: Facilitating Competition

12. Do you consider that supply chain exclusivity should be permissible under the enduring regime? If not, do you have proposals for enforceable measures for precluding it?

Yes. We believe that it is likely that, overall, more benefits will be realised from encouraging competition within the supply chain rather than focusing on OFTO competition. However we have concerns over the extent of the supply chain and the feasibility of effective competition, especially in early tender rounds. Therefore we believe that long term framework supply agreements with the supply chain may drive down costs more effectively.

13. Do you consider that the option of bidding on the basis of indicative costs and tendering after appointment has merit?

Yes. As stated previously, we doubt that the supply chain will be able and willing to provide firm designs and costs for every bidder (including the compliant and any variants) and so this approach may have to be developed out of necessity, if excessive risk premiums and contingency sums are to be avoided. Provided an appropriate proven approach (such as used in other, large public/private financed capital projects incorporating open book costing, maximum expected revenue streams, 'gain sharing' etc) is developed to support and facilitate this we believe there will be benefits from pursuing this approach.

Although we are supportive of developing innovative approaches in the interests of improving the process, we suggest that Ofgem should implement a 'dry run' test of the arrangements – including suggested key variations – and involve representatives of the key players in this. This should help to flush out any issues and allow further refinement prior to implementation.

14. Do you support our minded to position that explicit steps to facilitate new entry should not be included in the enduring regulatory regime?

Yes. In addition, we believe that no specific incentive should be given to encourage innovation.

15. Should we include provisions in the enduring regime to ensure that access to offshore cable capacity and to offshore cable routes is made available? If so, what form should those provisions take?

No. We believe that there are sufficient provisions within existing legislation and regulatory frameworks to allow this to happen. For such a requirement to be fully satisfied a zonal or strategic approach will be required such that a single OFTO is responsible for developing the offshore assets in a single zone for multiple users. However, we accept that there will be benefits arising from co-ordination of cable routes and landing points etc and that this should be encouraged.

Chapter 7: Tender Timings

16. Do you support, or have alternative, proposals for amending the key stages of, or otherwise stream lining, the tender process?

Yes, we welcome any steps that lead to a streamlined, simpler and quicker tender process that suits specific projects' needs. We suggest that there is merit in considering an alternative approach to the tender process that could enable it to be condensed further – see our general comments and answer to question 5.

We believe there is merit in Ofgem setting out the maximum tender time period for each project and encourage (through incentives?) a best endeavours approach to truncating it.

A timely tender process is critical to a generator. The generator has little involvement in the tender process (but this is an aspect with which we are very uncomfortable – see our answers to chapter 8 'Bid Evaluation') and so it will be important that Ofgem publishes regular progress reports during each tender round to all parties involved in, or depending on, that specific tender round.

17. Do you consider that the timings outlined will provide sufficient time for bidders to develop robust tender submissions and Ofgem to assess them?

We believe that the process as proposed is too long and that an 8 months ((3 month pre-qual and 5 month ITT) period should be adequate to select and appoint an OFTO. Bidders will take however much time is allowed to provide bids but even then design – and therefore costs – will not be fully finalised or firm. It is doubtful if the bidders and supply chain will develop, at significant

cost, fully firm designs and costs for every tender opportunity when they are unlikely – or will not want to – win every tender.

We suggest that our alternative approach outlined in our general comments and our answer to question 4/5 (where bidders submit initial high-level bids and then the OFTO is selected following a BAFO stage between 2 short listed bidders) would allow the tender round timescale to be condensed.

However, we also acknowledge that projects may have unique and specific characteristics – not least of which is their required connection date - that mean tender rounds may need to be longer and so the tender process should be sufficiently flexible to allow this.

18. In order to ensure an effective and timely procurement process through the supply chain, how long should the ITT stage last?

As stated previously, we do not believe that the supply chain will be able, or willing, to fully engage with every bidder in each tender round. Therefore, the ITT stage should be set to meet the generator's requirements and we suggest that, at most, it should be of 5 months duration – 3 months submission and 2 months evaluation.

Chapter 8: Bid Evaluation

19. In which areas should we allow variant bids?

We wholeheartedly support the principle of allowing variant bids to encourage innovation and efficiency and variant bids should be allowed in any areas of the tender. However, in order to ensure that the generator's project requirements are being met, variant bids should be allowed if supplementary to a fully compliant bid. Once again however, we believe that the appropriateness of determining the areas in which variant bids should be allowed should be agreed on a project specific basis.

We suggest that it should be possible for the generator to specify areas where variant bids must be submitted – 'mandatory variants' - such as increased standards of security of supply, redundancy. In particular we see this as being a way to address some of the issued raised in chapter 10 regarding extending the OFTO revenue stream beyond the initial 20 years period. In some circumstances it may be desirable and appropriate to extend the OFTO revenue stream by, say, up to 5 years but the generator is unlikely to be able to secure a cost effective arrangement for this period, either through negotiation with the incumbent OFTO or through a tender process. Therefore, a mandatory variant bid at the outset could be used to set out the terms under which the generator could request this and the OFTO would offer it.

Referring to our earlier suggested approach to refining the tender process (see general comments and question 4/5) we believe that variant bids will be more easily facilitated (particularly in respect of supply chain engagement and tender evaluation) if only 2 'preferred' bidders are involved.

20. How should variants be treated in evaluation?

Provided a variant bid is submitted along with a compliant bid and the variant bid provides overall benefit to the project, then it should increase Ofgem's evaluation of the bid submission.

21. Do you have a view on the factors we should consider in evaluating bids?

As we have stated previously, Ofgem are managing the tender process and so, in evaluating bids, should consider factors that enable them to assess the viability, feasibility and appropriateness of the bid against the generator's requirements.

Selection of the OFTO is key to the success of the generation project and we are concerned that the generator – who is, after all, exposed to all of the costs and much of the risk - has insufficient

opportunity to input to, and influence, the overall tender process, especially in evaluating bid submissions. For example, the generator should be directly involved in assessing the merit and value of variant bids and negotiations with bidders over programme, levels of security and redundancy etc. To try to do this with the generator being kept at arms length will be inefficient and is unlikely to be successful. In addition, Ofgem will assess the economic efficiency of a bid. However, as the generator is exposed to all of the costs (either directly or through the TNUoS tariff), and in the absence of an OFTO of last resort, the generator should be able to decide if the bid is economic against its project requirements and to agree to underwrite any deemed inefficient costs by negotiation with the bidder. If this allows the project to proceed, and without delay, this may be more acceptable to the generator.

Although this should be reviewed on a project specific basis, the factors proposed by Ofgem appear reasonable. We are concerned however that there appears to be strong emphasis on the costs to the consumer without recognising that focussing only on cost does not provide a rounded value for money solution. There is a clear risk of future cost escalation if a low cost solution is selected where the selected bidder then fails to deliver to time and specification or to meet the availability criteria. All public sector value for money evaluation methodologies for major projects consider issues of financial and technical competence, quality and deliverability (as well as cost) as part of that value for money solution. We are not clear how the interests of current and future consumers can be met with such a limited focus on cost.

We also believe that the criteria must be wider than this and include consideration of the costs to the project.

In assessing such bids, we would also consider other factors such as health and safety management methodologies, experience and track record; proposed construction methodology and management approach; use and management of subcontractors; technical capability and experience; delivery milestones and programme; operating availability guarantees; level of electrical losses; resources (including management, finance etc); relationship with us (eg previous experience, any outstanding commercial or legal disputes).

To give generators, bidders and the supply chain confidence in the robustness of the evaluation process a high degree of transparency will be required. We would value Ofgem making available to all entrants to subsequent tender rounds, the tender scores and outcomes of all previous tender rounds.

We also suggest that industry stakeholders should be involved in developing the high level form of a generic scoring system that would be refined as required for each project tender round.

Supplementary - Assessment of Losses

Subsequent to this consultation being issued, Ofgem issued a letter raising consideration of the assessment of losses.

We believe that bidders' losses proposals should form part of the assessment criteria and should not be given significantly (if any) higher evaluation priority over other criteria. In setting out our requirements from the OFTO and offshore assets, we expect to specify the allowable level of losses that the bidders' designs should achieve. This would constitute a feature of a compliant bid and reduced levels of compliance would only be considered under a variant bid and acceptance of these proposals subject to negotiation and agreement with the generator.

Chapter 9: Revenue stream and incentive mechanisms

22. Do you consider that the existing incremental capacity incentives should be amended and, if so, what form should they take?

Although there seems to be some confusion over the now proposed approach to this we believe that, in the interests of efficiency, flexibility to reflect technology developments and achieving project programmes, appointed OFTOs should be able to offer incremental capacity expansion without the need for a further tender process. This will require a methodology for revising the allowed revenue stream, and any and all generators that this directly affects should be party to negotiations on this. However, only where such incremental capacity benefits, and adds value to, generator(s) should the allowed revenue stream be adjusted.

We suggest that to facilitate these negotiations, bidders' incremental capacity proposals could form part of a 'mandatory variant' bid.

We have general concerns that any incentives (availability, incremental capacity etc) seem to favour the OFTO and we would prefer to see a more balanced approach to this, to reflect the fact that the generator is exposed to the majority of costs, risks and losses of the OFTO arrangements.

23. How, if at all, should the existing availability incentive be updated for the enduring regulatory regime?

We welcome Ofgem's proposal to issue further analysis and thinking on the availability incentive mechanism as we believe that there are some significant issues and concerns raised by the current proposals.

As stated earlier, we have general concerns that incentives are designed to favour – and therefore encourage – OFTO bidders. We understand the reasoning behind and recognise that, although incentives need to be meaningful and effective, they also need to be reasonable and realistic so that they do not present a barrier to bidder participation. However, we believe that greater recognition should be given to the risks, losses and liabilities that the generator faces by making incentive mechanisms more balanced, at least, or even giving a stronger incentive to OFTO performance.

The risks, losses and liabilities faced by the generator far outweigh the penalties faced by the OFTO. The consequences of an offshore grid failure could easily result in availability dropping drastically, largely at the generator's cost. We therefore suggest that the incentive mechanism should not only strongly discourage poor performance but should reward above expected performance. This should be a criteria of the bid assessment and evaluation process where measures to ensure high levels of availability (eg redundancy) should be recognised. This further emphasises the need for the generator to be involved in bid assessment, evaluation and negotiation to determine the acceptable level of cost and risk it is willing to accept.

In the interests of transparency we see merit in Ofgem publishing annually the availability records of all OFTOs.

24. What is your view of the inclusion of a re-financing claw back mechanism?

Provided the generator has sufficient input to specifying its requirements; assessing and evaluating bids and negotiating any variants and incentives, then we believe it has sufficient certainty in the terms to mean such a mechanism is unnecessary. However, if it is deemed appropriate to include such a mechanism then sufficient safeguards should be included to ensure that the generator is not adversely affected or disadvantaged and benefits to some extent.

25. Do you have evidence of insurance market volatility that suggests that an incentive would be in the interests of consumers?

No, only anecdotal. We believe that the insurance market will be very cautious in this area and cover and premium could be volatile. As a result we expect that bidders will include a (potentially significant) risk premium in their revenue stream bids. Therefore, if this is felt to be significant, then an appropriate incentive should be implemented that encourages the OFTO to ensure that insurance is appropriate for the project's needs. The generator will be exposed to this risk premium and so should benefit from any efficiencies made in this area.

Chapter 10: Responding to future developments

26. Do you have comments on the practicality of the potential options for dealing with the future developments outlined?

Offshore generation projects are likely to have an operating life in excess of the initial 20 year OFTO revenue stream. Whether this is the case – and to what extent – will only be known as offshore experience develops but we suggest that adequate provision and flexibility should be developed for this as soon as possible.

At the early stages of developing the enduring OFTO arrangements, much of the industry were keen to see more flexibility in setting revenue stream periods (mainly by allowing the generator to specify the required period) but this was not taken on board. This would have addressed some of the concerns raised by this issue and would be worth reconsidering.

We anticipate that unless a further tender is held, the generator will be in a very weak negotiating position with the incumbent OFTO. Even if a tender is held, the incumbent will still be able to exert considerable influence over terms to be offered. The tender process should include specific provisions to counter this.

Of perhaps greater concern, is the more likely situation where the generator plans to continue operating his assets for a relatively short period of time after the end of the initial OFTO revenue stream period - say, up to 5 years. In these circumstances, it is unlikely that a further tender will be viable or successful. Therefore, provision needs to be included to address this. Our previous suggestion (of the generator specifying a requirement for a 'mandatory variant' to include the basis of terms for such an extension) is worth further consideration to address this concern. Such terms should address pricing for the use of assets that have zero economic value.

27. Do you have alternative options for addressing the issues raised?

As stated above, we believe that our previously suggested use of a 'mandatory variant' bid to set out the basis of terms for extending the initial revenue stream period has merit.

28. Are there other issues regarding future offshore developments which you consider need to be addressed?

Interconnections will assume greater strategic importance in the future and although the arrangements should be developed to support and encourage them this is an aspect that is likely to benefit from experience of how the arrangements operate, how they need to develop and how policy, regulation and industry respond to them.

Ofgem appear to recognise the potential benefits of a co-ordinated, zonal approach to the provision of offshore assets especially for interconnections. However, responsibility for promoting this lies with the industry and NGET without any policy framework being in place to shape this. Although the industry generally recognises that there is potential benefit in such a co-ordinated approach without such a policy framework it is unlikely to be delivered.

In addition, without some recognition of the importance and value of anticipatory, or strategic, investment there is a conflict such that generators that would otherwise be competing will be driven by ensuring that their projects are not exposed to delays, unnecessary costs or risks and are not disadvantaged by another generator's actions.

Provided projects are, at least, not disadvantaged by other projects' actions, then interconnections should be pursued in the interests of efficiency. However, if offshore grid assets are used in the future to 'interconnect' other project(s), then the original generator should realise reduced 'sole use' offshore transmission charges.

In considering interconnections (either between projects or between jurisdictions) careful consideration will need to be made of the issues arising from the currently proposed 'point-to-point' approach to appointing OFTOs. In particular, the arrangements need to address the interaction between and interfaces between different OFTOs having been appointed for different sections of the interconnector.