Balfour Beatty

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Mr Colin Green
Ofgem
9 Millbank
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Dear Mr Green

Offshore Electricity Transmission

Balfour Beatty welcomes the opportunity to comment on the joint Ofgem / BERR consultation (the "Consultation") published on 27 July 2007.

Balfour Beatty is interested in this consultation for two reasons. Firstly BB Group has interests and expertise in owning and operating infrastructure assets; and secondly Balfour Beatty Power Networks Limited (BBPNL) is one of the world's **leading electricity transmission construction** companies.

On behalf of Balfour Beatty we would like to offer the following response to the Consultation. Generally we believe that to encourage new market entrants to participate in a regulated market, Ofgem needs to provide a stable and transparent regime. With this in mind, the following is a summary of the key points that we would like to make on the Consultation, with detailed responses included in the attached appendix.

- **The end of the OFTO licence period** - There are several scenarios and considerations regarding what might happen at the end of the licence period. These scenarios might have a material impact on all stakeholders and therefore we would like to see greater clarity. For example, if the life of the Generator's plant were to be extended, would there be a corresponding extension of licence? If the licence is extended should it be subject to a price control review, or be retendered or be subject to a bilateral agreement? Does the length of the licence extension influence the choice? Given that the life of the transmission asset is likely to be greater than the 20 year licence period, what is the position regarding transfer of the decommissioning risk and liabilities if a different OFTO is appointed after 20 years? We would like to see a clearly set out structure in this regard.

- **Revenue adjustment** - Regarding the need for Ofgem to provide stability for investors, we are unclear why Ofgem feel it necessary to review and possibly adjust the revenue allowance of the successful bidder prior to awarding the OFTO licence. Where a bidder has won the bidding process with a bid that contains an expected level of revenue, we cannot see the case for altering this revenue allowance at the 'eleventh hour'.

- **Predefined adjustment mechanism** - Ofgem has expressed the view that the potential distortion to the competitive process that a predefined adjustment mechanism could cause, could outweigh the benefits of having such a mechanism. While we recognise Ofgem's concern regarding the uncertainty that this element may introduce over the life of the OFTO's licence, we support the use of an adjustment mechanism to manage exceptional risks.

- **Costs of funding the tender process** - We recognise the role Ofgem will play under the proposed regime and whilst we consider it reasonable for Ofgem's costs to be funded we firmly believe that the costs of running the tender process should sit with the client initiating the tender. This is the case for all other tender processes in which we participate, and we believe that bidders should only be responsible for their own costs and, if successful, recover these within the OFTO revenue.

- **Tender application window** - As an investor, a co-ordinated application window may be beneficial as it presents the opportunity to bid simultaneously for different projects, thereby creating cost synergies. However, we recognise the Generators' concerns regarding the risk of project delay that an annual tender application window might introduce. Some industry participants have also discounted an annual tender window to avoid peaks in resource requirements. A more flexible regime may be a bi-annual tender window, as we believe that this will address the concerns of the Generators and still allow for synergies from the investor base.

- **Prefeasibility study** - For reasons of efficiency, we believe that the Generator should undertake all reasonable feasibility study work prior to making their application for connection to the GBSO. The information gathered under the feasibility study should be made available to the OFTO bidders to prevent duplication of costs. Any concerns over commercial sensitivity which the Generator might have could be addressed by bidders being required to sign confidentiality agreements.

Balfour Beatty hopes that Ofgem and BERR find our response a useful input to the development of the licencing and regulatory regime for offshore transmission networks, and we await the next stage of this process with interest. In the meantime if you require any clarification on any of the comments presented in this letter please do not hesitate to contact either of the undersigned.

Yours Sincerely

[signed on original]

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Appendix 1 – Consultation response and questions

Chapter One – Introduction

n/a

Chapter Two– Overview of the offshore transmission regulatory framework

n/a

Chapter Three – Design of regulatory regime

Question 1: Do you agree with our proposals for the design of the regulatory regime as outlined in this chapter? In particular, we would welcome your views on

- *the role of the OFTO and the obligations that it would undertake;*
- *the regulatory and contractual framework, including the duration of (and what happens at the end of) the revenue stream, predefined adjustment mechanisms, transfer arrangements, and business separation requirements;*
- *the form and quantum of performance incentives;*
- *dealing with changes to Generator requirements; and*
- *the allocation of risk.*

We broadly agree with the roles and obligations of the OFTO. However, we would seek greater clarity on the technical and performance obligations of the OFTO. We support a minimum technical standard for all OFTOs. We are of the view that all parties must be clear on the impact on the OFTO's performance obligation as a result of a deviation from the minimum technical standard or the introduction of a 'variant' bid. Minimising as much as possible OFTO specific conditions will create comfort in the investor base and will aid future tender processes.

There are several scenarios and considerations regarding the licence period. These scenarios may have a material impact on all stakeholders and therefore greater clarity is required. For example, should the life of the Generator's plant be extended, would there be a corresponding extension of licence? If the licence is extended should it be subject to a price control review, retendered or a bilateral agreement? Does the length of the licence extension influence the choice? Given that the life of the transmission asset is likely to be greater than the 20 year licence period, how should the decommissioning risk be managed? We welcome further discussion or clarification from Ofgem.

Ofgem proposes to require that holders of offshore transmission licences do not also hold a current onshore transmission licence. For Generator affiliates, this requirement is not proposed. There may be a concern that Generator affiliates may have a competitive advantage in bidding for these projects.

We believe that performance incentives should be symmetrical, i.e. the OFTO should be entitled to a reward if performance exceeds the agreed targets, in the same way as a DNO is rewarded if it exceeds its CI or CML target.

Where a Generator requests a network connection to a higher standard than the minimum specified in the SQSS, we believe that the Generator should be exposed to the full costs or benefits of the variation.

As presented in the summary, we believe that the Generator and winning bidder should fund Ofgem's running of the tender process. We support Ofgem requiring Generators to pay a

substantial fee on the connection application. We see this as an incentive for the Generator not to cancel or delay the development.

We agree that the OFTO should bear the operational risks, but because of the 'single shot' approach to setting the revenue allowance, we would expect the licence to reflect these potential risks and contain amelioration clauses or use of a revenue adjustment mechanism.

Chapter Four – Enduring competitive framework

Question 1: Do you agree with our proposals for the enduring competitive process as outlined in this chapter? In particular, we would welcome your views on:

- *the use of an annual tender application window;*
- *the design of the tender process, and the stages we have outlined;*
- *recovery of tender costs; and*
- *running the tender process.*

Question 2: Do you feel that there is any aspect of the enduring tender process that we have not considered sufficiently?

As an investor, a co-ordinated application window is beneficial as it presents the opportunity to bid simultaneously for different projects thereby creating cost synergies. However, we recognise Generators' concerns on delay risk if their indicative offer of connection is not signed by a particular date thereby preventing them from participating in the annual tender application window. Some industry participants have also discounted an annual tender window to in order to avoid peaks in resource requirements. We believe that a bi-annual tender window will address the concerns of the Generators and still allow for synergies from the investor base.

We welcome the reduction in tender process stages to four stages. We believe that the tender process can be completed in a shorter time frame than proposed. Once the ITT is launched it is our opinion, based on our experience, that the transaction can be completed within a 3-4 month time frame.

We would like to suggest that Ofgem publishes the 'pre-defined criteria' in order to ensure that only contractors who can meet these criteria respond to the Expression of Interest document. Providing the circumstances of the bidders have not changed materially and they continue to meet the pre-defined evaluation criteria, these bidders could automatically qualify for the ITT stage.

There are two aspects of the ITT stage that warrant further discussion. The first is the licence application fee and the bid bond, and the second is the variant bid. We would like to understand Ofgem's rationale in seeking a licence application fee at this stage and not at the preferred bidder stage. We recognise the role Ofgem will play under the proposed regime and whilst we consider it reasonable for Ofgem's costs to be funded we do not agree with the use of a bid bond or fee payable at ITT. An alternative is a development fee paid by the winning Offshore Transmission Owner (the "OFTO") and the Generator to Ofgem. We would welcome a debate as to the quantum of costs the development fee should cover – partial, full or capped costs? In our experience, the costs of running a tender process have not been met by bidders and may deter bidders as their bid costs are already very high.

Having a Bafo stage increases the risk of delay, so we would like to suggest that this stage be instigated only if there are a number of short listed preferred bidders.

Section 4.28 in the Consultation states "the Authority would need to scrutinise and decide whether to approve the revenue stream". Where a bidder has won the bidding process with a bid that contains an expected level of revenue, we cannot see the rationale for altering this revenue allowance at the eleventh hour.

As a Generator is required to undertake impact assessments and consultations for the generation sites and cable routes, we do not think that these costs should be passed to the OFTO. Any charge levied at the bidding stage would act as a disincentive, and any charge levied on the successful bidder would have to be paid for out of the revenue allowance.

Given the need for independence, credibility and expertise in running a bid process, we concur that Ofgem is the party best placed to do this.

Chapter 5 – Transitional arrangements

Question 1: Do you agree with our proposals for the transitional arrangements as outlined in this chapter? In particular, we would welcome your views on:

- *the pre-conditions for qualifying transitional projects;*
- *the tender process for transitional projects, and whether they capture the potential projects that will require adoption;*
- *the transfer of assets; and*
- *interaction with the enduring regime.*

Question 2: Do you feel that there is any aspect of the transitional arrangements that we have not considered sufficiently?

The comments that we have made under Chapter 4 regarding the tender process under the 'enduring regime' are also applicable under the 'transitional arrangements'.

For transfer of assets, where the Generator appoints the OFTO in a timely manner and the OFTO designs and constructs the asset, we believe the design and construction risk should sit with the OFTO. Furthermore, incentives should be placed on the Generator to ensure that they do not take decisions that will result in them being the OFTO of last resort.

We support the suggestion that the first enduring tender process should occur as soon as possible after the 'go-active' date.

Chapter 6 – Connection application process

Question 1: Do you agree with our proposals for the connection application process as outlined in this chapter? In particular, we would welcome your views on:

- *the pre-application process;*
- *the indicative offer process (stage 1);*
- *the final offer process (stage 2); and*
- *the roles of the Generator, the GBSO, and the OFTO in this process.*

Question 2: Do you feel that there is any aspect of the connection application process that we have not considered sufficiently?

Question 3: We outline two options for annual tender application windows. Which of the following options do you think are appropriate?

- *Option 1: A mandatory annual tender application window, to be incorporated into the offshore connection application and tender process; or*
- *Option 2: To rule out an annual tender application window and allow Generators to realise cooperation benefits independently and optionally.*

For reasons of efficiency we believe that the Generator should undertake all reasonable feasibility study work prior to making their application for connection to the GBSO. The

information gathered under the feasibility study should be made available to the OFTO bidders to prevent duplication of costs. Any concerns that the Generator may have regarding commercial sensitivity could be addressed by requiring bidders to sign confidentiality agreements.

Ofgem proposes a two-stage approach, comprising an indicative offer (Stage 1) and final connection offer (Stage 2), for offshore Generators seeking connection to the transmission network, with the Generator being contractually obliged to secure the cost of any of the works being carried out once it accepts the final connection offer. This exposes the potential OFTO to the risk of the Generator aborting the tender process prior to final offer. We therefore support the proposal to ensure that the Generator pays a connection application fee that reflects the costs of the connection work and tender activities it causes. We are receptive to different fee structures – lump sum or ramp up staged payments as long as the incentive exists to prevent the Generator from aborting the process for an invalid reason.

We are assuming that during Stage 1 a party bidding to be considered as an OFTO will not be required to supply any information to support the GBSO's indicative connection offer. This being the case, we would recommend that the GBSO calls on the advice of an expert in offshore construction in order to give an offer that is within an acceptable level of accuracy. Failure to do so could place unreasonable expectations on the bids from potential OFTOs.

We support the extension of the GBSO role offshore, and we reiterate that the Generator should make available to bidders information regarding routes that may have been obtained by the offshore Generator.

Please see Chapter 4 responses for our views on tender application windows.

Chapter 7 – Connection via distribution networks

Question 1: Do you agree with our proposals for connection via distribution networks as outlined in this chapter? In particular, we would welcome your views on:

- *comparable types of connection;*
- *charging arrangements; and*
- *connection application processes.*

Question 2: Do you feel that there is any aspect of connection via distribution networks that we have not considered sufficiently?

We have no comments on this chapter.

Chapter 8 – Charging, access and compensation

Question 1: Do you agree with our proposals for charging, access and compensation as outlined in this chapter? In particular, we would welcome your views on:

- *the development of charging arrangements;*
- *access products; and*
- *compensation proposals, particularly whether there should be a penalty only regime in place for the OFTO.*

Question 2: Do you feel that there are any aspects of charging, access and compensation that we have not considered sufficiently?

We support the development of an offshore charging regime using the current GB onshore charging methodology with National Grid as onshore and offshore GBSO designate. The onshore methodology is understood by industry participants.

We agree that the offshore access product should take into account the fact that the minimum security standard offshore would not require circuit redundancy in the design of offshore transmission connections which may lead to a restriction of the output of the Generator. We welcome a minimum security standard for offshore connections as this will provide transparency. We would propose that clear guidance is given on how and when compensation payments apply. Compensation payments should be aligned with the access product and level of infrastructure available. We believe that for incentives to be effective they should not be purely punitive. Therefore we would like to see the introduction of symmetrical incentives where the OFTO is penalised for under performance against targets and rewarded for out performing targets, in much the same way as DNOs are currently penalised / rewarded for failing / beating their CI and CML targets.

Ofgem proposes in section 8.37 a penalty payment to incentivise OFTOs to maximise availability of offshore transmission networks for use by offshore Generators. Is this for other 3rd party Generators? Ofgem refers to "pre-emptive action against unavailability of assets". We are unclear as to how this pre-emption would work in practice?

In the event that an offshore Generator is constrained because of an onshore network issue, we would like Ofgem to clarify if they expect the OFTO to receive compensation or will the OFTO's revenue be assured irrespective of actual load flow.

Chapter 9 – Technical rules

Question 1: Do you agree with our proposals for technical rules as outlined in this chapter? In particular, we would welcome your views on:

- *security standards; and*
- *the recommendations for developing technical rules.*

Question 2: Do you feel that there is any aspect of technical rules that we have not considered sufficiently?

We are supportive of the need for an "industry group to consider the scope and role of the OFTO role". However, we would like to see Ofgem call for some representation from potential OFTOs on this group and some input from experts in the construction of offshore networks.

Chapter 10 – Implementation issues

Question 1: Do you agree with our proposals for implementation as outlined in this chapter? In particular, we would welcome your views on:

- *changes to licences; and*
- *changes to codes.*

Question 2: Do you feel that there is any aspect of implementation that we have not considered sufficiently?

On the subject of STC Governance, on the basis that the OFTO price review is expected to be set once and run for 20 years, we can see no need for an OFTO to have a regular seat on the Grid Code Review Panel ("GCRP"). However we would expect all OFTOs to be on the circulation list for routine papers etc, and for all OFTOs to be given access to submit, in person, questions / proposals to the GCRP at any time during the 20 year licence period.

Chapter 11 – Work programme

Question 1: Do you agree with our proposed work programme as outlined in this chapter? In particular, we would welcome your views on our proposed approach to industry engagement.

Question 2: Do you feel that there is any aspect of our proposed work programme that we have not considered sufficiently?

The work programme as outlined in the Consultation is challenging but feasible. We have found the industry engagements useful and would welcome the opportunity to participate in further Ofgem / BERR workshops.