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Dear Richard

Offshore electricity transmission: Updated proposals for the competitive tender process

Scottish and Southern Energy (SSE) welcomes the opportunity to comment on Ofgem's updated proposals for the management of the competitive tender process that will determine the granting of offshore electricity licences to new offshore transmission asset owners (OFTOs).

While we generally support the approach set out in the consultation paper, we are concerned that the weighting of financial and non-financial criteria during the tender process, and some of the associated tests, will not result in an effective competition. In particular, we note that it is proposed to place more weighting on financial criteria throughout the tender process than operational ability and managerial competence. The effective operation and maintenance of transmission assets is key to the success of this regime and, as such, we strongly believe that operational capability needs a more prominent role in the assessment criteria, particularly at the early stages of the tender process.

Our detailed comments on the proposals in the consultation document are set out below.

Pre-tender requirements for projects

We support Ofgem's proposal to separate the pre-conditions in the transitional regime, and also introduce some flexibility with respect to the qualifying project pre-conditions.

We welcome Ofgem's decision that the Sale and Purchase Agreement (SPA) should be project-specific and included in the data room by the developer concerned. We also agree that the developer should have the option to include an offer to provide operation and/or maintenance (O&M) services in the data room. The terms of such an offer for O&M services should be determined by the developer concerned. With regard to the operation of the data room, we believe that this should be kept open throughout the tender process with the developer able to remove, add to and/or amend documents at any time so long as such changes support a more efficient tender process.

We note Ofgem's concern, expressed in paragraphs 4.22-4.25, over the timing of asset transfer in the transitional regime and what this might mean for OFTO project financing. We agree that this is an important issue, not just from the perspective of the OFTO but also from the perspective of the offshore developer. Offshore generation projects will be developed incrementally, where from the first turbine onwards there will be one part of the development generating while other parts are under construction. It is, we understand, proposed to transfer transmission assets to the OFTO at the 'Go Live' date, potentially while construction continues elsewhere, and hence raising issues over the asset transfer process, interactions during ongoing construction, and responsibilities (not least for safety) during the transitional operation of transmission assets.

The discord between the prescribed timeline of the OFTO tender process and ongoing construction of the offshore generator (which is highly dependent on, for example, weather conditions) clearly needs to be reviewed on a project-by-project basis as part of the pre-qualifying process. An important element of this review should be for the developer, as part of its data room submissions, to detail the processes and contracts that would oversee this transitional operation period. One consequence of this review might be the need for temporary exemptions from the requirement for a transmission licence during the construction period.

We agree that Ofgem's proposals for the pre-conditions in the enduring regime appear reasonable.

Tender process

We broadly support Ofgem's proposal for a two-stage pre-qualification. The conditions attached to the pre-qualification (PQ) and qualification to tender (QTT) stages should reasonably focus on demonstrating financial, managerial and operational competence rather than identifying the lowest cost potential bidder.

The key elements, in our view, of an effective pre-qualification process are to measure operational capability; to review the effectiveness of the O&M strategy; identify the required unitary and ongoing payment schedule; and demonstrate robust financial standing. Underpinning this regime is the requirement to transfer energy from the offshore power station to the onshore grid and the GB electricity market. The success (or failure) of the regime will be

measured against achieving this which, in itself, is a function of the availability of the offshore transmission assets. In this regard, the operational capability of prospective OFTOs is critical and hence needs to be at the front-and-centre of the pre-qualification process.

We note the proposal to weight the financial criteria (economic and financial robustness) at 60% of the final score, and non-financial criteria at 40% of the final score (20% for management and legal capability, and 20% for operational capability). No reasoning has been provided in the consultation document to justify these weightings. In our view, the operational capability, supported by managerial competency, should be the primary criteria when assessing the merit of a prospective OFTO. Hence we believe these weightings should be reviewed. SSE would support weighting operational capability at 60% of the final score supported by a minimum pass/fail threshold for operational capability.

The proposed tests to assess operational capability are ill-defined in this consultation document and, as a consequence, it is difficult to comment in detail. At a minimum, we believe that these tests should assess experience in the operation of transmission assets (and, where this experience has been gained overseas, knowledge of the GB system); include for a clear safety plan (perhaps with input from the Health and Safety Executive); and evidence of a risk-based approach to the operation and maintenance of transmission assets. We would welcome further discussions with Ofgem on this issue.

In relation to the proposed tests for assessing economic and financial robustness, the proposed PQ net asset test is stronger than the proposed QTT turnover test (which does not meaningfully measure financial standing), and we would suggest supplementing the QTT turnover test with a revisiting of the PQ net asset test at the project-specific QTT stage to address any changes to the bidder's interests or proposals between the PQ and QTT stages. The purpose of the proposed QTT project IRR test is not clear to us, and would welcome clarification of how this test is proposed to be applied.

At the invitation to tender stage, it is proposed to evaluate bids largely on the basis of the firm revenue stream, i.e. the competition would be price-based. While we understand the reasons for focussing on price at this stage of the tender, we believe that it will also be necessary to revisit operational capability as part of the assessment criteria to ensure the most effective outcome. Given that Ofgem is procuring the OFTO but it is the developer that will be impacted by O&M strategies, we continue to strongly believe that the developer's views need to be solicited and taken into account during the tender process. One approach might be to ask generator developers to assess and comment on proposed O&M strategies and deliverability.

One perverse consequence of a price-based approach to the evaluation of bids might be to remove the scope for innovation and value that the offshore transmission regulatory regime purports to encourage. A price-based approach promotes the lowest cost network solution but not necessarily the lowest cost energy. For example, the proposed interruption incentive caps an OFTO's revenue exposure to unavailability of the transmission assets by transferring risk to the offshore generator. If the OFTO bid is 'blind' to the cost of unavailability beyond the cap on

the interruption incentive (which in itself is not linked to the value of lost energy) then a sub-optimal solution might result. Again, this would argue for wider consideration than a price-base approach to recognise design, operational and managerial criteria that affect the overall cost.

We welcome Ofgem's proposal that the offshore developer is involved in the invitation to tender stage through a moderated dialogue facilitated by Ofgem. Such dialogue is, in our view, essential to a successful tender particularly in the transitional regime. This dialogue will allow offshore developers to make a timely contribution to the process rather than storing up issues for the revisions to the Bilateral Connection Agreement offered by National Grid once the licence has been granted.

Cost recovery principles

SSE supports the draft cost recovery methodology set out in Appendix 8 to the consultation document.

I hope these comments are helpful. Please do not hesitate to get in touch if you want to discuss our response further.

Yours sincerely,

Aileen McLeod
Regulation Analyst