

Offshore Transmission Final Consultation
Department of Energy and Climate Change
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Our Reference NG/MR

Dear Sir/Madam,

Offshore Electricity Transmission – A further Joint Ofgem / DECC Regulatory Policy Update – 23 March 2009

Thank you for the opportunity to comment on the final consultation document. This response is from National Grid in respect of our interest in becoming a potential investor in offshore transmission networks (OFTO). It has been prepared by National Grid's Business Development team who are separate from National Grid Electricity Transmission (NGET).

National Grid continues to base its consultation responses on helping to make the regime the best for UK energy consumers and to enable the UK to meet its 2020 renewable energy targets. This letter focuses on the final key issues we wish to raise with the proposed regime. Appendix A responds to certain questions raised and Appendix B provides some additional points for your consideration.

Our concerns around the proposed regime are well known and we remain concerned that the arrangements will not generate the necessary strategic plans, encourage synchronised activities of multiple OFTOs and support the vital supply chain coordination - all of which we believe is essential if the UK is to meet its targets. However, we do recognise windfarm developers are being reminded of the potential to actively coordinate their Round 3 OFTO requirements and note the enhanced coordination between on and offshore transmission.

This response will focus on; 1) our belief that the regime should allow and encourage the OFTO to be appointed early in the process and 2) that there should be complete confidence in a fair competition between generator affiliated and independent OFTOs.

1.) Enduring projects - bidding environment

To support our view that the UK's offshore transmission's ambitions are best served by appointing the OFTO early the following will compare and contrast the two options of appointing the OFTO early and late in the process.

If the OFTO is appointed late

A late appointment should deliver more price certainty for the transmission element of an offshore windfarm. This is very likely because of the requirement to bid a final cost with a menu of scenarios to accommodate changes of timescale and specification following the final GBSO offer. The only way to achieve certainty under the regime is for the prospective OFTO to be asked to bid as late as possible, against the least amount of activity and risk. This requires the generator to have first de-risked the project by:-

- Splitting the zone into the smallest possible packages
- Performing consents
- Performing seabed surveys
- Conducting transmission design so as to provide a very tight specification and
- Procuring the long lead time items such as cable, converter stations, transformers, marine cables installation and switchgear

If the OFTO is appointed early

An early appointment would provide a flexible, consistent, responsive and higher quality transmission service across a Round 3 (or other geographic) zone to the generator. This requires the OFTO to be selected against a less precise and broader strategic generator specification. However the OFTO would perform all the tasks described above and adapt the transmission design accordingly.

Comparison

The advantages of the late appointment are:-

- The bids will have the least amount of caveats and be in the firmest position (subject to financing being held pending the final generator decision)
- The bids will be the easiest to compare
- The generators will have had to take so much of the risk that it would be extremely unlikely that they would pull out of the windfarm and strand the connections assets/investment.

The advantages of the early appointment are:-

- Consenting authorities would have the advantage of considering the project as a whole rather than as individual pieces. There are concerns that some authorities may not accept these smaller consent requests as they would wish to understand the impact of the whole project (a routine approach).
- The generator and OFTO working together will be more capable of specifying the requirements to the GBSO and onshore TO to deliver a strategic solution capable of supporting the zone with minimum risk to the onshore system. Alternatively there would be many short term applications forcing piecemeal and more costly onshore reinforcement.
- There will be standard O&M practice across the zone and so less operational confusion and opportunity for mistakes
- The supply chain can tender to their ultimate client at an earlier stage. This reduces the contract risk but preserves competition at this level and encourages the suppliers to offer new and innovative products.
- The benefits of economies of scale in procuring O&M services from a very limited supply base for the whole zone and in holding fewer spare transformers and other equipment that would be standard across the zone
- The generator would gain access to OFTO finance earlier
- The generator could concentrate their resource on the windfarm
- The communication between generator, OFTO, supply chain, consenting authorities and GBSO can be enhanced and the focus can be on delivery instead of who is responsible and risking OFTO disqualification.

Overall

In the generator's OFTO tender strategy they must decide when to appoint the OFTO and in doing so must balance the requirement for OFTO bid certainty with the flexibility for the OFTO to consent, design, procure and build an electricity transmission system across land and sea. However, in reality the requirement to bid firm and final prices will greatly encourage the generators to select the late appointment option.

The current regime encourages a radial point to point deployment of transmission assets to connect these large offshore developments. However it is our belief that a more optimal solution could be developed by taking a longer and more strategic view through the early appointment of an OFTO. With appropriate coordination an offshore network could be deployed meshing together the wind farms, so offering enhanced reliability, availability and redundancy and delivering benefits for the UK consumer and the generators. This ensures the availability of renewable power to the UK grid where it is most needed and most cost effective. It is also possible, with the right investment and deployment of technology, to visualise an offshore network as an enabler to a more interconnected Europe delivering access to a number of significant power markets (and more renewables) that will bring benefits to the consumer through increased competition.

2.) Level Playing Field

In November 2008 we raised the issue of generator affiliated OFTOs bidding a risk premium in order to control a highly significant risk to their windfarm. Ofgem responded with an interpretation of the EU 3rd Package that generators could not bid. This view has been changed in the current consultation subject to generators complying with the EU regulation when implemented.

One concern is information leakage between subsidiaries so as to advantage an OFTO affiliate. However, we are generally confident that business separation arrangements will deal with that concern.

Given that business separation rules are effective and there is no information leakage there still remains a significant risk to the competition. It would be very difficult for Ofgem to not award a licence to a generator affiliated OFTO that bid lower than the rest of the OFTO bidders because of their bid being based on lower probabilities of major outage and cost of repair. Given that there is little experience of these projects, there are no accepted yardsticks to measure against.

From a group perspective the generator could conclude that it is advantageous to secure the OFTO for their windfarm because:

- Of overall greater investment comfort for shareholders and lower perception of risk from financiers of the windfarm project
- Of having the confidence that a repair will be responded to with great speed and quality even when uneconomic to the OFTO in order that the generator subsidiary can continue to generate the greater revenues and
- The OFTO assets can be sold at a later date to an OFTO of their choosing.

Prospective independent and commercially motivated OFTOs must have absolute confidence that the rules will not favour a generator affiliated OFTO.

Yours faithfully,

Mathew Rose

Appendix A

Consultation Questions

Question 1 – Supply chain and skills capacity. To what extent to which Ofgem, when granting OFTO licenses, should take into consideration the policies and processes proposed by each bidder for developing and maintaining the appropriate skills necessary for them to discharge their licence obligations?

National Grid welcomes opening the discussion on the supply chain constraints and that the UK is in competition for the supply chain's services in a global market that currently has an increasing demand for marine and transmission logistics and equipment. In response to the question, the ability of the OFTO to influence the supply chain development is dependant on when the OFTO is appointed and if the generator deems it necessary to perform the procurement ahead of OFTO tender. At present prospective OFTOs have little authority to influence the supply chain.

Early discussions with the supply chain have brought out the following points

- This is a step change over and above business as usual and capacity may not be available unless some certainty of commitment is given early.
- They would prefer to deal directly with the OFTO who would ultimately be the customer.
- Dealing with multiple OFTOs will increase costs as they will need additional resources to bid at each annual tender round.
- Innovation will be limited as they will bid a vanilla, off the shelf design to mitigate the impact of the annual bidding burden
- Leveraging of technology may not be possible without some form of design authority and standards to regulate future development and deployment.
- Other competing projects are already taking capacity making the challenge of meeting the 2020 targets immensely challenging for the supply chain.

Question 2 – Further views on a) our approach to predefined adjustments for known unknowns, b) the OFTO of last resort proposals and c) business separation requirements.

2a) National Grid welcomes the changes to adapt the performance obligations for each individual site. At what point in the tender process will the prospective OFTOs be able to view the performance obligations? Will Ofgem share their assumptions on outages as a result of maintenance activities?

2b) The current OFTO of last resort proposals do not set out how the negotiation on price and service will be conducted with the OFTO that is obliged to take ownership of an asset that has failed in tender. For the avoidance of doubt, in the final consultation can the end to end OFTO of last resort process be described?

2c) National Grid fully supports business separation requirements.

Appendix B

Additional Points

Other points that National Grid would like to raise are:-

- a) In the event that an OFTO provides an Enduring bid that is a variation of the generator specification but delivers a better product, it is understood that Ofgem will require the generator to re-write the specification and begin the tender again. In doing so the prospective OFTO that invested extra time and took extra bidding risk will lose the potential benefit. This practice will discourage any prospective OFTO from bidding an innovative design and will encourage them to simply bid against the specification. It will also increase bid costs, project delay and further encourage the generator to provide a very narrow specification to the point that the transmission design is 90% done.
- b) At present Ofgem have not published their thoughts on the timescales for an enduring tender. Greater clarity on this would greatly assist a prospective OFTO's plans to prepare to bid and manage suppliers' tenders to support the OFTO bid in a manner compliant with the EU Procurement rules for utilities.
- c) In the event that an OFTO wishes to divest itself of the OFTO assets and licence, can OFGEM provide guidance on what the expected process would be.
- d) The current rules on generators supply chain and prospective OFTOs being able to communicate is severely constraining product and project design and development. We encourage DECC/Ofgem to relax the rules to allow parties to hold workshops ahead of the OFTO tender. This increased level of communication could encourage more prospective OFTOs into the market as they could gain more visibility of the projects up for tender and gain a greater understanding of the risks involved with marine transmission.