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Date : 12th February 2010

Dear Sam,

Offshore Electricity Transmission: Consultation on the Enduring Regime

Thank you for the opportunity to respond to this consultation. We have answered the questions from the consultation in the attached annex.

We believe that the Enduring Regime should be flexible enough to accommodate project specific arrangements and ongoing developments in offshore networks. In particular, it must be able to respond to future interconnection requirements and the creation of a “supergrid”

There are a couple of specific points we would like to highlight which are not included as questions in the consultation.

OFTO of Last Resort

We note that, at this stage, Ofgem feel it is unnecessary to revisit their decision not to include an OFTO of Last Resort in the Enduring Regime. We strongly believe that there must be some provision to ensure that projects are not prevented from progressing due to the failure of the tender process. It is very unlikely that the Enduring Regime will deliver an efficient offshore transmission system if there is no effective remedy for the failure of a tender process. The alternative approach of multiple, repeating tenders until an OFTO is identified, will lead to unnecessary cost and delay. Consequently, we strongly urge Ofgem to carry forward the OFTO of Last Resort, for use at first tender failure, into the Enduring Regime.

Extending the Transitional Regime

We note that Ofgem propose that extending the transitional regime, as far as allowing the developer to construct transmission assets, is outwith the scope of this consultation. However, we suggest that this option should become part of the Enduring Regime. It is

critical that the tender process does not delay construction of offshore wind projects and we believe that, in the interests of time, the developer should retain the option to construct the transmission assets prior to a handover to the OFTO. As well as avoiding potential delays in construction, this may also reduce the likelihood of a failed tender process in that the OFTO will be bidding for a constructed asset, thereby reducing their construction risk.

Over and above these specific issues and the questions answered below, we remain doubtful about the ability of the Enduring Regime to deliver either best value for consumers or a stable investment environment. This approach does not facilitate a coordinated approach to delivering an efficient and economic offshore network. Instead, the focus on point to point connection removes any real incentive for interconnection between projects, the onshore system and neighbouring European countries. We are concerned that this could lead to a fragmented and higher-cost transmission system, which may ultimately threaten the UK's ability to connect the planned 30GW of offshore generation and meet its 2020 renewables targets. We would therefore urge Ofgem to review the outcome of the Offshore Regime following the tender awards for the first transitional round.

Yours sincerely,

A handwritten signature in black ink, appearing to be 'Samantha Ridsdale', written over a horizontal line.

Samantha Ridsdale
Regulation Analyst

Section 4 – Triggering the tender process

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

We believe that the generation project developer is key to triggering the tender process, particularly in light of the financial commitments which must be made by the developer at this time. Additionally, the generation project developer has the clearest understanding of the project timing and will act according to its schedule. It is therefore critical that the commencement of the tender process following a request from the developer does not incur delay. It is also important that the NETSO provides input from the ODIS to ensure that the most appropriate onshore connection site is identified at the earliest stage. In addition, as detailed above, we believe that the developers should have the option to initiate the tender process after the assets have been built.

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 appt and when that should be?

The generation project developer should be allowed to request the commencement of a tender process as early as they choose. Given the financial commitment which is made by the developer prior to the tender request, it is expected that a final investment decision will have been made by the developer at this time. We do not support a mandatory latest date for initiation of the tender process as we believe that the timing decision should be left to the developer. However, we expect that the developer will be mindful of the time required to secure consents, complete the design process and commission the transmission assets prior to proposed project connection date.

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

The proposed conditions seem reasonable other than stipulating a fixed time period between tender request and energisation date. We believe that the developer should have flexibility in triggering the tender process and this condition would remove that flexibility. Additionally, we propose that rather than the developer having to have “entered into a Crown Estate lease” the developer should have an “Agreement for Lease”. The actual granting of the lease takes a considerable length of time however working from the point of “Agreement for Lease” would ensure that projects are more likely to achieve target connection dates.

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

We do not yet have a view on what time of year the tender window should be open. We propose that there should be more than one window per year to facilitate timely tender awards. It is critical, however, that once the timings for the windows have been set, that they are not moved around and amended. If the developer has to submit the request for commencement of the tender process in line with the windows, rather than on an ad hoc basis, they must have certainty on the timing of this process.

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

Contingency is a standard mechanism for managing unknown and uncertain costs. The separate specification of contingency costs by the OFTO is the best method of both quantifying the risks involved in each project and preventing the inclusion of opaque risk premiums in the bids. As each project may be very different from the next, it is important that the OFTO has flexibility in what it perceives to be a contingency item and also the costs associated with them. It should be more

straightforward for Ofgem to compare bids when a list of contingency items is supported by a risk management strategy. In addition, it would not be appropriate for Ofgem to set a cap on these costs. If the contingency costs are transparently taken into account when assessing the OFTO bid, this process should encourage the OFTO to keep these costs down where possible.

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

As stated above, it would not be appropriate for Ofgem to cap the contingency costs. Offshore transmission construction is complex and risky and contingency is simply a method of managing this risk. To cap contingency costs would only lead to the inclusion of opaque risk premiums in the OFTO bid.

Which items do you consider should be defined as pre-construction costs?

All costs incurred prior to committing supply chain should be treated as pre-construction costs. This would include items such as surveys, consent costs and environmental assessments. In the interests of meeting target connection dates, it is important that the developer is able to undertake sufficient pre-construction works with the understanding that these will be covered by the tender process. This is particularly relevant should there be a variant bid accepted which might negate pre-construction works already completed.

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

Within reason; the agreement should be modifiable for project-specific circumstances.

Section 5 – The scope of the tender

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?

We agree with Ofgem's minded-to position in this regard. Given that a key driver for the tender regime is the encouragement of innovation, it would not seem appropriate to limit the OFTO to a prescriptive tender specification. However, it is unclear how bids which provide different innovative solutions could be fairly compared with each other. Certainly, there should be acknowledgment of how willing the developer is to accept additional risks associated with an innovative solution. As Ofgem are looking for solutions which provide "best value for present and future consumers", there could be a large degree of subjectivity in the comparison process which cannot be resolved by simply referring to the lowest cost option. For example, the best value for present and future consumers may be to provide a solution which provides over-sized capacity and encourages future interconnection. Whilst, in isolation, this may not appear to be a lowest cost option, when considered as part of a future offshore energy network, the early construction of this type of transmission asset may, in fact, prove to be providing best value. It is unclear whether the current tender process is capable of producing an effective decision from such a complex set of variables.

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

We believe that bidders should be given flexibility to respond to the specification as they see fit in order to encourage innovation and best value solutions. However, as stated above, the assessment criteria for bids should be clear.

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

We do not agree that capacity oversizing should be excluded from the enduring regime. Although it may provide some difficulty when assessing bids, it is important to allow this as an option if innovation and best value solutions are to be encouraged. However, it raises a question over future tenders if capacity oversizing is financed by the initial developer.

Presumably, if extra capacity is built in during the initial project this removes the requirement for a future tender process as the next developer can simply connect to the oversized capacity. On the other hand, initial oversizing may well provide a lower cost solution in the long run.

To minimise cost to customers, minimise environmental impact and allow for timely development, the Enduring Regime needs to be able to deal with strategic investment. In our view, this is currently a major weakness in the proposed approach.

Section 6 – Facilitating competition

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?

If the bidder was to be required to respond to a prescriptive tender specification, then certainly supply chain exclusivity may hamper competition. However, in the event that a bidder has developed an innovative solution to a more flexible tender specification, a certain degree of supply chain exclusivity may be appropriate.

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

Although we understand the rationale, we believe that there is little merit in bidding on the basis of indicative costs as it builds more uncertainty into the tender process. Indicative costs could be largely different from outturn costs in the case that a “non-standard” design is chosen. This could lead to additional risk premiums being built into the bid and then an economically incorrect result from the tender process. Wherever possible, the costs should reflect the actual design specified in OFTO’s bid.

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

We agree with Ofgem’s minded-to position in this case.

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?

We agree that European legislation is clear on access to transmission systems and given that offshore transmission assets are simply a part of the wider GB transmission network, we have no reason to believe that the obligation on TSOs to make access available should be any different than it is on land. This obligation should be detailed in the OFTO licence conditions.

Section 7 – Tender timings

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

We support the proposals for enhancing the PQ stage and removing the QTT stage of the tender process. It is important that the process be as stream lined as possible for both OFTO bidders and developers.

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

We consider that the proposed timescales meet both the requirement for a stream lined process and sufficient time for the bidder to develop their submission. Given the potential for variant bids, it is critical that Ofgem have enough time to evaluate the bids without extending the process on an ad hoc basis. As mentioned in Section 4, we do not yet have a view on when the tender windows should be open.

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

We agree that the ITT stage should last for six months. The overall process should run to no longer than thirteen months and should not be allowed to be extended on an ad hoc basis to guarantee certainty for both OFTO bidders and the developer.

Section 8 – Bid evaluation

In which areas should we allow variant bids?

We believe that variant bids should be allowed in all areas, otherwise the scope for innovation is unduly limited. If the tender process is to be effective in revealing the best value solution, it is important that a wide range of options are considered. If the bidder is required to demonstrate how the variant delivers best value to present and future consumers, this should naturally find an optimum solution. It is key that there are clear, measurable assessment criteria and that the views of the developer are taken into account.

How should variants be treated in evaluation?

Any bid, variant or not, should be evaluated to assess whether it provides best value for present and future consumers. This should ensure that not only short term, low cost options are taken into consideration but also long term, low carbon, forward looking solutions. However, in evaluating a variant bid, it is important that actual costs are included rather than proposed indicative costs mentioned previously. This will ensure that the developer has a complete picture in determining whether they are agreeable to a variant bid. It is also critical, at this stage, that the variant bid does not introduce delay or the risk of negating pre-construction works and the associated costs. For example, it is important that the NETSO is involved prior to accepting a variant bid if the onshore connection point varies from the initial NETSO proposal. It may introduce unnecessary delay to the project if the accepted variant bid proposes an onshore connection point which is incompatible with the NETSO's expectations. Equally, a variant bid with this characteristic may result in unrecoverable pre-construction costs being incurred by the developer who is working to a different , NETSO-agreed onshore connection point.

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

First and foremost, we believe that there should be an evaluation of the operational competency of the OFTO in delivering and maintaining the transmission assets. Should the OFTO fail to prove its operational competency, there is little point in assessing additional criteria as there is a fair possibility that the project may fail. We agree that capital cost, transmission losses, financing, managerial competency and carbon consequences could be considered in the evaluation process. However, onshore operational costs are not necessarily within the sphere of influence of the OFTO or the developer. Due to the complex “black box” models employed by the NETSO, the effect of the bid on onshore constraints is not transparent to either the developer or the OFTO. Furthermore, it can be demonstrated that onshore constraints do not occur as expected following changes of network, generation or demand. Therefore, it does not seem appropriate to evaluate the expected onshore operational impact of the bid when many other variables, outwith the control of the bidder, have potentially greater impact on onshore operational costs at the connection point.

Section 9 – The Revenue Stream and Incentive Mechanisms

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

We believe that the incremental capacity incentives within the transitional regime should be carried forward into the enduring regime, recognising the more fundamental issue of facilitating strategic investment referred to above.

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

We also believe that the existing availability incentives are sufficient for inclusion in the enduring regime.

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

It is accepted that the cost of financing during the construction phase will be higher than during the operational phase. Therefore, we believe that the OFTO should include, in their bid, a step change in financing cost to reflect the end of the construction period. As long as the bids include this change in financing cost, we do not believe it would be appropriate to include a re-financing claw back mechanism. Verification of this should be included in the evaluation process. However, if there is no planned change in financing cost following the end of the construction phase, there may be merit in a claw back mechanism.

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

Whilst we have no evidence of insurance market volatility, we believe that, as with financing costs mentioned above, insurance costs may be higher during the construction phase and reduced during ongoing operation. As long as this is reflected in the bid, there should be no requirement for an incentive to manage perceived insurance market volatility.

Section 10 – Responding to Future Developments

Do you have comments on the practicality of the potential options for dealing with the future developments outlined? Do you have alternative options for addressing the issues raised?

It is not yet clear how best to deal with assets at the end of the 20 year revenue stream or to integrate and value asset upgrades during this period.

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

It is critical, especially given the creation of the North Seas Grid Initiative, that the OFTO Enduring Regime supports interconnection both with other Member States and future generation projects. Currently, the regime is skewed towards a point to point solution rather than a coordinated network and as long as this focus continues, it is unlikely to encourage any type of interconnection. This being the case, the present proposals are likely to hamper the UK's efforts to meet its 2020 renewables targets. Therefore, the issue of future offshore development needs to be considered as an integral part of the enduring regime rather than as an issue for the distant future.