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16 February 2012

Offshore Electricity Transmission: Consultation on Tender Exercises under the Enduring Regime

Mainstream Renewable Power Response

Mainstream Renewable Power is a leading renewable energy company developing renewable energy projects across several continents. The Company expects to be a major provider of renewable capacity for the UK and has a development pipeline in excess of 5,000MW.

We are developing onshore wind projects in North America, South America, and South Africa. In the German North Sea, we are developing the 1200 MW Horizont project.

In the UK, we are developing two large offshore wind projects. In Scottish territorial waters we are developing the 450 MW Neart Na Gaoithe project. Additionally, through the SMart Wind consortium, we are developing the 4000MW Hornsea Round 3 zone with our partners, Siemens Project Ventures. Transmission charging is a critical area for all generators, and particularly so for offshore renewables.

We support the ongoing refinement of the Enduring Regime and expect it to deliver a workable solution which meets the needs of offshore developers and generators. It is vitally important that the Enduring Regime provides a coherent basis for development over the medium/long term, in order to promote confidence.

Mainstream Renewable Power is committed to assist Ofgem and DECC to deliver a successful offshore regime and we welcome the opportunity for continuing engagement wherever possible.

Summary

We are very concerned with the lack of pace in development of the enduring regime. Whilst we are broadly supportive of the direction of travel from Ofgem, the pace of change is too slow. Industry has previously identified many of the key issues and suggested ways forward to address them, in some cases over two years ago. Industry engagement with the process could not be more focussed, yet core key issues still remain unresolved against a largely static regulatory and policy backdrop. The regulatory certainty on these key issues requires to be delivered more quickly in order to ensure timely delivery of projects which is critical to achieve 2020 targets.

We believe that in considering the development of the Offshore Transmission Regime it is important to retain a strong focus on its central reason for existence – and to act accordingly in designing the regime. This reason is to provide an effective, timely and efficient means for offshore generators to deliver their power to the National Grid. What it is not and should not be, is an exercise in developing a theoretical OFTO process framework whilst failing to address the legitimate needs of what are its primary customers – generators.

Along with other generator stakeholders in the offshore arena, we have delineated in each of our responses to the various Consultations on the evolving Offshore Regime, those issues which are of key importance to us, as the primary customer.

Following the decision to include a Generator Build option in the Enduring Regime in 2010, we noted the requirements to facilitate this option in delivering the benefits identified. Since that decision, developers have continued to invest heavily in their projects in the anticipation of meaningful clarification of enduring regime processes. Whilst we welcome the news that more detail is to be provided by Ofgem and DECC the lack of a holistic approach to regulatory reform in the offshore arena remains of concern.

As such we are disappointed that the Consultation on tender exercises under the Enduring regime does not appear to have thought through the process in sufficient detail to provide the clarity which generators considering this option require.

We note the requirements associated with the “late” OFTO appointment. We also have concerns regarding the difficulties that some of the proposed processes present for an offshore developer/generator and these are detailed in our responses to the individual questions.

The timely consenting and development of an efficient network encompassing both onshore and offshore components is an essential element in delivering the UK’s offshore wind ambitions.

As a developer, we have a primary interest in a fit-for-purpose Offshore regime which meets OUR needs as well as those of prospective OFTOs and provides us with workable low risk options for both OFTO build and Generator build. We consider that there is still further work to be done to achieve this.

There remain issues with regard to:

- the process of transfer of transmission assets to the OFTO. In particular, confirmation is still required from DECC/Ofgem as to how a generator can reasonably commission transmission assets without breaching the requirements of the Third Package on unbundling, which was not intended to provide a barrier to the development of the UK’s offshore transmission regime, but to deal with *long term* separation of assets. The issue has been in process for a considerable time and requires a positive resolution.
- the ability of the regime to promote and secure a coordinated, fit for purpose offshore network

- the ability of Offshore developers to evaluate with confidence, complex integrated connection offers received from National Grid. Whilst the provision of integrated offers by NGET is a helpful development, driven by licence requirements regarding the development of an efficient, coordinated and economic transmission network, the regulatory uncertainty surrounding their status means that developers still face significant risks. The connection agreement is a fundamental component of any project. We still do not have resolution on issues surrounding consenting, funding, and building of the integrated offshore grid. The continuing lack of clarity in this area is proving a significant challenge for developers.
- Consultation on any integrated aspects of the connection process has been left to the anticipated DECC/Ofgem paper on coordinated networks, with decisions at the earliest in “mid 2012”
- The need to clearly specify the appropriate compulsory purchase powers required by generators in order to deliver a successful Generator Build option remains unfulfilled, with DECC and Ofgem seeking to provide clarity in “early 2012”.
- Continuing uncertainty regarding the path of charging as applied to offshore networks. Despite the work of Project TransmiT, there has only been a high level consideration of offshore charging largely based on the “radial” model. The charging ramifications of coordinated/integrated offshore networks, eventually tied in with wider interconnection and the emerging requirements of the single European market has not yet been sufficiently addressed.
- Compatibility between TNUoS charges and deemed 20 year asset life. We expect offshore transmission asset lives to be longer than 20 years. If this is the case, generators will have been overcharged for use of the asset, with no means of redress. This issue needs to be resolved as part of the overall review of offshore charging.
- Asymmetric risk of OFTO delay. Under the OFTO build option, the risks associated with late delivery will have an impact on the OFTO but a far greater impact on the generator if they are prevented from exporting power at their contracted date. Stronger incentives on timely delivery are required on the OFTO to offset this significant risk for the generator. Without this ameliorating action, the risk of late delivery due to OFTO shortfall will need to be incorporated in the overall consideration of the generation project, resulting in increased cost or potentially unhedgeable risks.

The Need for a Workable Generator Build Option

The document provides further clarification of the processes under the Enduring Regime for both Generator Build and OFTO Build options. However, the majority of the work and the focus of the document appears to have been directed at the OFTO build option. It is worth noting that all offshore transmission development has so far been under the auspices of “generator build” and this needs to be a workable option under the enduring regime. As such we look forward to the clarifications required regarding the generator build option being swiftly delivered, with an added impetus towards reducing uncertainty, barriers and costs for generators wishing to pursue this option.

The enduring regime should provide a real choice for developers, not one conditioned by more onerous or uncertain variables being applied to one option over another. We are supportive of a well functioning OFTO build option, but it will not come about as a result of providing industry with an incomplete or higher than necessary risk Generator Build option – it will delay deployment. We note in particular the intention to remove the cost guarantee from the generator build option and the reduction of interest allowed during construction as negative developments.

Further consideration is required in relation to the timing of the OFTO process under Generator Build - in particular the need to strike the right balance between i) having sufficient certainty of (e.g. construction) costs to make the tender exercise as meaningful as possible; and ii) the need to ensure that the OFTO will be in place at the right time and that there is no undue delay between appointment of OFTO and the operation of the transmission assets.

A critical part of this is the need to provide for some flexibility in cost recovery provisions, for example to allow for unavoidable costs overruns whilst the tender process is taking place and construction work ongoing. The absence of any minimum cost guarantee is also a serious omission and if not corrected, will lead to an increased risk premium being applied. Further guidance and certainty is required for developers as to what costs they will be entitled to recover. The publication of previous costs assessments from the transitional projects is helpful but is insufficient to provide the necessary degree of certainty for enduring projects. This unnecessary risk will also be reflected as a risk premium into developer costs.

The prospect that legitimate expenditure by generators under generator build to mitigate delay risks and maintain critical options may not (with the benefit of “perfect” hindsight) be considered “economic and efficient” by Ofgem is of significant concern, as is Ofgem’s recent decision to reduce the interest during construction allowance from 10.8% to 8.5%.

Yours faithfully

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CONSULTATION QUESTIONS

CHAPTER: Two

Question 1: Do you have any views on the approach outlined in paragraph 2.8, namely to focus on a single OFTO build option and not to develop the early OFTO build option further at this stage?

A: We agree with the approach.

CHAPTER: Three

Question 1: What are your views on the proposed arrangements for triggering a tender exercise?

A: As noted above NGET as NETSO are only offering “coordinated” connection offers to offshore generators and therefore “the assets involved would not just be for the use of a sole generator”. We therefore require urgent clarification on how both Generator and OFTO build can operate under “coordinated offers”.

Question 2: What are your views on whether our proposal on generator security will ensure the appropriate level of commitment from a generator?

A: An appropriate level of security is reasonable. Securities retained by Ofgem should be based on actual costs incurred. However, it should be noted that there are a variety of reasons why a generator may decide to change its build preference (including concerns over the OFTO/processes themselves) and flexibility will be required in the security regime in order to incentivise and allow the optimum overall outcomes to be achieved.

Question 3: Do you agree with our proposed approach to the tender specification for an OFTO build tender exercise?

A: The approach appears reasonable. However, it should be noted that the bilateral connection agreement allows NGET to flex the anticipated interface point. Therefore the tender cannot specify this point absolutely.

Question 4: Are the proposed arrangements for pre-construction works the most appropriate for investors and generators?

Question 5: What other information, if any, in addition to that referred to within the tender specification and pre-construction works sections, would be needed within the data room for the project?

Question 6: What do you think would be the best approach to ensuring bidders have access to and confidence in a seabed survey undertaken by the generator?

A: Bidders’ confidence in the data will depend partly on the specification of the survey and more importantly on the party undertaking the survey, the contractual arrangements plus the liquidated damages and warranties associated with the survey.

Question 7: With reference to the approach to seabed surveys outlined within paragraph 3.22, what might be the best approach to developing an independent generic survey specification that would be acceptable to both generators and potential bidders?

A: We do not believe that the proposal to develop an “independent generic survey specification” has any merit and should not be pursued. The time required to develop such a specification, reach agreement with stakeholders, gain the required level of acceptance and commitment would further delay the deployment of offshore generation. We have serious concerns as to whether the level of detail required to be meaningful/useful is compatible with the ambition to be “generic”. If this cannot be achieved it has little value.

Question 8: Do you agree that ensuring procurement is undertaken by the OFTO through the tender process would be the most economic and efficient approach?

A: **No.** Considering the demands of project delivery timelines and long lead-time equipment e.g. HVDC export cables etc., production capacity *will* need to be booked *ahead* of obtaining consent. In this respect it is essential that the generator should have the flexibility to procure, whether by open tender, framework agreement, or ‘open book’ arrangement with strategic partners.

Question 9: What are your views on whether there are supply chain constraints associated with the manufacture and delivery of some key offshore transmission assets? If there are constraints, do these vary significantly in relation to project design?

Question 10: What are your views on the examples of alternative approaches for supply chain engagement under OFTO build outlined in this section?

A: For onshore wind generation projects it is not unusual for developers to enter into arrangements with suppliers for long lead time items and to transfer these arrangements to EPC, turnkey or balance of plant contractors. In many cases these types of arrangements are key to facilitating a timely efficient project process.

The suggested hypothetical third party contracting complications brought about by the generator undertaking procurement can be effectively dealt with: e.g. production capacity can be reserved based only on MOU/LOI and down-payment. We strongly disagree with the contention that the inefficiencies alluded to in 3.29 would materialise.

Question 11: Are there any other approaches we should consider under OFTO build to enable the supply chain to be engaged in time to ensure project delivery timescales are met, whilst maximising opportunities for competition through the tender process?

A: It imperative that developers are allowed to continue to engage with the supply chain during the design and specification of their projects so that the optimum solution can be arrived at taking account of technical and commercial requirements, costs, risks and timescales.

Other arrangements with suppliers exist such as partnering, joint ventures, preferred suppliers etc and the regime should accommodate these arrangements.

Question 12: Should there be any restrictions on interactions between parties, either before or during a tender exercise in order to ensure fair and effective competition and best value for consumers?

A: No. There should not be any restrictions on the interactions between parties as this will inhibit innovation, cost reduction initiatives and also increase risks and costs for the parties with a consequential detrimental impact on consumers.

Question 13: Do you agree that the current 20 year revenue stream provides the best value to consumers under the enduring regime (OFTO or Generator build)? If not, what alternatives should we consider?

A: No. 20 years is too short a life for many of the assets in question. Ofgem should engage with the emerging thinking from National Grid on appropriate charging structures for offshore assets. There is merit in decoupling the OFTO revenue stream from the transmission charging cost recovery exercise.

Question 14: What are your views on our proposed treatment of risk relating to:

- delay to licence grant?
- weather delay?

Question 15: Are there other areas of risk which would be more efficiently managed (for consumers) through a risk sharing mechanism rather than factored into bidders' TRS bids? If so, can you suggest how these risks might be shared?

A: A primary and significant source of risk is delay by the OFTO, for a variety of reasons outside of the generator's control. A generator needs to have confidence that the regime sufficiently incentivises the OFTO to meet its required timescales and where this does not occur, full redress is available. The more OFTO risk is artificially placed on the generator, the greater the risk premium required by developers.

Question 16: Is the current approach to recovering bid costs appropriate for OFTO build? If not, what alternative approach to recovering bid costs would you recommend?

Question 17: Are there any aspects of the current transitional arrangements or within the proposals for OFTO build, including revenue term, bid requirements and risk profile, which may prevent access to certain sources of finance in the enduring regime?

Question 18: Do you have any comments on the issues associated with incorporating a refinancing gain share mechanism and how such a mechanism could be structured?

A: Refinancing is a potential part of many projects' financial makeup over their lifetime. The conditions under which it is possible or desirable are individual to each project. Attempting to specify under what conditions there has been a "gain" and apportioning a share of that gain will have a detrimental impact on the sector and deter investment. It also has the flavour of a one sided retrospective "reopener" which again has the potential to damage business confidence. We refer to our previous comments on the need to learn from the experience of PFI/PPP initiatives in order to inform any deliberations.

Question 19: Do you have any preferences from amongst the options outlined for how the PQ stage should operate?

A: The PQ stage must not delay the tender which could be the critical path in project delivery. Once this criterion is satisfied, then the PQ should allow the maximum number of bidders and the greatest flexibility in PQ. Ofgem should ensure that the benefits of additional bidders and competition are not lost due to artificial constraints on its administration costs.

Question 20: Are there any other ways that a PQ stage might operate in order to meet the objectives set out at the start of this section?

Question 21: Do you have any preferences from the options outlined for how the ITT stage might operate?

Question 22: Are there any other ways that the ITT stage might operate to ensure its efficiency and effectiveness?

Question 23: What are your views on the proposals for involving generators in evaluation of bids? In particular, what key technical aspects of bids would be most important for generators to evaluate?

A: Generators have a critical role to play in evaluating tenders – they are the primary customer and the sole reason for the tender being in existence.

Question 24: What are your views on the proposals for involving NETSO in evaluation of bids? In particular, what key technical aspects of bids are most important for NETSO to evaluate?

Question 25: Are there areas on which you think allowing variant bids under OFTO build would add value to the process and to consumers?

Question 26: What are your views on generators recovering efficiently incurred pre-construction costs at the point at which the transmission construction works are completed?

A: Efficiently incurred generator pre-construction costs should be recovered immediately. They should not have to wait until construction works are completed. This would align generators (who are acting in the role of offshore TOs) with onshore TOs in this respect.

We note the proposal not to compensate generators if their planning application is turned down. This is unacceptable and is adding a financial penalty to other costs of delay, appeal and reapplication faced by the generator. We are not aware of any similar approach taken for onshore TOs.

Question 27: Do you have any early views on the appropriateness of design incentives for transmission asset lifecycle design, e.g. transmission availability, quality of installation and transmission losses?

Question 28: What are your views on whether the current approach to indexation, and in particular the proportion of the TRS subject to indexation, provides the best value to consumers? How might any alternative approaches be managed?

Question 29: Do you agree that additional delivery incentives for OFTOs are not necessary?

A: We strongly disagree. Additional incentives on OFTOs are essential as the risks of financial losses faced by generators unable to generate from their projects are much greater than the financial losses faced by an OFTO who is late. The result of such an imbalance is that costs to the consumer will rise due to the increased cost of capital imposed on the generators. Any LDs need to be paid to the generator (whether that is directly or indirectly via the NETSO).

Question 30: What are your views on what approach to decommissioning of assets would provide best ongoing value to consumers?

A: This area requires much greater consideration and detail than that available within the terms of this Consultation. We look forward to proper engagement following the publication of relevant documents in the Spring.

CHAPTER: Four

Question 1: What are your views on whether there are benefits under Generator build to the generator undertaking the seabed survey against a comprehensive generic survey specification agreed by industry?

A: We do not support the use of generic survey specification

Question 2: Do you agree with the approach that Ofgem continues to run tender rounds for groups of projects, not necessarily limited to one per year, or would you recommend an alternative approach?

A: Tender rounds should be flexible and as frequent as necessary to meet individual generators' critical paths.

Question 3: Do you think there are further efficiencies we could make to the tender process and the transaction procedures for Generator build which would increase their efficiency and provide greater certainty to bidders and funders?

Question 4: Are there any changes to the information supplied in the data room which would improve the efficiency of the process for Generator build?

Question 5: What are your views on the benefits of involving generators in evaluation of bids as outlined in this section?

A: Generators have a critical role to play in evaluating tenders – they are the primary customer.

Question 6: Do you have any suggestions on amendments which would improve the efficiency of the process for finalisation of transfer documentation and which would maximise value to consumers?

Question 7: What do you consider might be the implications of a share sale approach as opposed to a transfer of assets as has been seen to date?

A: We support the inclusion of the option of a share sale approach. It provides one effective way in which to ring-fence assets that will be transferred to the OFTO. Any concerns Ofgem may have in this area regarding the balance of assets and liabilities included in such an arrangement can be effectively addressed by appropriate provisions. The more flexibility that the regime offers in terms of transfer arrangements, the better.

Question 8: Do you agree that the current split between costs priced into the TRS and those allowed as pass throughs provides best value for consumers?

Question 9: Are there any aspects of the current arrangements for transitional tender exercises or within the changes we have proposed above, including revenue term, bid requirements and risk profile, which may prevent access to certain sources of finance under Generator build?

Question 10: Do you have any comments on the issues associated with incorporating a refinancing gain share mechanism for Generator build and how such a mechanism could be structured?

A: There is now a significant body of experience built up under the various PFI/PPP initiatives undertaken by government in relation to re-financing gains. Ofgem should base their proposals for such a mechanism (if one is pursued) on the lessons learned from that arena.

CHAPTER: Five

Question 1: Are you satisfied with the practical relevance of our definition of the terms ‘phase’ and ‘stage’?

A: Phase is related to a single Final Investment Decision. Stage is not as clearly defined.

Question 2: What are your views on the measures we propose to determine whether a stage or phase within a site/zone qualifies for a single tender exercise?

A. Flexibility should exist that allows phases that are to be constructed sequentially but are electrically linked (connected to the same onshore NGET substation) to qualify for a single tender exercise.

Question 3: What are your views on whether running a separate tender exercise for each phase within a site/zone would best meet the objectives of the enduring regulatory regime?

A. Separate tender exercises limit the opportunity to exploit economies of scale and scope. Additionally, adverse environmental impact increases due to increased cable route land-grab (and sea-grab) due to operating restrictions/clearances etc. imposed by different OFTOs