National Grid House
Warwick Technology Park
Gallows Hill, Warwick
CV34 6DA

Paul Whittaker
UK Director of Regulation
Paul.whittaker@uk.ngrid.com
Direct tel +44 (0)1926 65 3190

www.nationalgrid.com

Giedre Kaminskaite-Salters
Offshore Enduring
Ofgem
9 Millbank
London, SW1P 3GE

17 February 2012

Dear Giedre

Offshore Electricity Transmission: Consultation on tender exercises under the enduring regime

National Grid Electricity Transmission plc (NGET) welcomes the opportunity to respond to the above consultation. Under its Transmission Licence NGET has responsibility as the National Electricity Transmission System Operator (NETSO) in GB and as the transmission owner (TO) onshore in England and Wales.

As NETSO we have a crucial role in providing the interface between offshore transmission owners (OFTOs), onshore TOs and offshore generators. We are also responsible for the production of the Offshore Development Information Statement (ODIS) and the Seven Year Statement (SYS) which together inform market participants about the opportunities for connecting to the National Electricity Transmission System (NETS). Also we are affected, as the TO in England and Wales, by the offshore transmission networks developed under the OFTO regime that interface with our transmission system. Finally (in partnership with Scottish Power Transmission Limited) we are developing the Western HVDC link from Hunterston through the Irish Sea to Deeside and so have some insight into the issues of developing transmission infrastructure offshore in addition to onshore.

This response is on behalf of NGET and is not confidential

Key Issues

The challenge faced by the industry is to make the best transmission investment decisions (on behalf of consumers) against a background of considerable uncertainty. Transmission licensees are faced with requests for connection which are considered reasonably certain to proceed, while at the same time sometimes being aware that future (and so less certain) developments in the same general locations may also take place over the longer term. Transmission licensees therefore need to make the best decisions taking account of the need to deliver, now and in future, both capacity to specific projects, as well as providing the necessary wider transmission capacity. A key factor in this is determining the right proportion of wider network to be provided onshore, or because of environmental or other considerations, offshore. The decisions will also need to accommodate the integration of new interconnectors and the possibility of a “north sea grid”. Transmission licensees are obliged to undertake these considerations and development of the transmission system in a manner that is “…efficient, coordinated and economical…” in accordance with the various licence conditions and which takes into account the environmental obligations contained in section 38 of the Electricity Act.

Against this background it is almost inevitable that there will be times when the interests of a particular generator developer (not bound by the same statutory and licence obligations) will conflict

with the approach that transmission licensees identify which seeks to develop an overall optimum solution and so minimise costs to the end consumer rather than to the project in question. We therefore welcome the fact that Ofgem have now taken on board our concerns over the importance of the enduring offshore regime being able to accommodate an integrated approach to the development of network infrastructure. We look forward to Ofgem's forthcoming consultation on this issue in the Spring which we hope will address these concerns and minimise the risk that the enduring offshore regime contributes to an uncoordinated approach and leads to higher than necessary costs to the consumer or to delays in delivering infrastructure to meet our customers' needs.

All transmission licensees also have obligations to coordinate their activities and we will play our part using the available tools provided by the industry framework. Principally this will be through the dissemination of information to the industry via the ODIS and the SYS so that parties can make efficient and coordinated and economical transmission investment decisions. We will continue to develop these documents to ensure that the market is as well informed as possible.

The time and effort involved in developing the non-standard arrangements[1] required for the current transitional offshore transmission projects has far exceeded the levels originally estimated. This was perhaps inevitable as a result of the evolving nature of the offshore regime. We hope that by developing the enduring regime before it is used in anger some of the transitional issues (and costs) can be avoided. For this to be the case it will be essential that the regulatory regime clearly specifies roles, responsibilities, rights, and obligations of all the parties and the need for appropriate cooperation between them. Furthermore it should be recognised that all OFTO parties need to undertake the full scope of the role that they are responsible for and that they should fully understand the requirements of the regulatory framework (in particular the STC). The PQ and ITT processes should be developed to ensure any appointed bidders / OFTO's meet these requirements

We continue to have concerns that the generator build option within the offshore regime is inconsistent with the unbundling provisions of the EU third package. This is likely to be a particular issue where there may be multiple projects in a particular area, perhaps competing to use a route corridor with limited capacity and where the 'first mover' may (whether deliberately or not) have an ability to significantly disadvantage competitors through its design choices. One of the key objectives of the third package was to require unbundling of transmission from generation in order to prevent generators involved in transmission being able to discriminate against competitors or disadvantage them through under investment (Recitals 9 and 11 of the Electricity Directive[2] refer). By providing generators with the opportunity to develop transmission under the 'generator build' option the offshore regime appears to conflict with the objectives of the Directive. The argument that the transmission network developed by generators is "not transmission" until it starts to transmit power is misses the point because discrimination can take place through the design or routing of that network, or through under investment. Given that the development may be undertaken by an un-licensed party it is unclear what ability Ofgem has to prevent such discrimination (or to require coordination) and we consider that the approach that Ofgem are proposing for the onshore competitive regime in which potential developers will be required to obtain a "light licence" might be capable of modification to address the generator build model. If such an arrangement were practical then it could ensure that developers of offshore networks have the appropriate obligations (including non-discrimination, and the development of economical, co-ordinated and efficient network) which should be in the interests of all consumers.

There are a number of issues related to the planning regime that may prove problematic.

[1] As compared to the standardised agreements between the NETSO and the Scottish transmission owners.

[2] Directive 2009/72/EC concerning common rules for the internal market in electricity

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In particular we are concerned that it is unlikely to be possible to obtain planning consent for major onshore reinforcements if stakeholders and the IPC are concerned that proposals developed by offshore generators are not sufficiently coordinated and appropriately future-proofed.

We have specific responses in relation to some of the questions that Ofgem has raised in the consultation which we have set out in the appendix to this letter. If you would like to discuss any of the points we have raised or have any questions regarding them then in the first instance please contact Andy Balkwill (andy.balkwill@uk.ngrid.com or 01926 65 59 88)

Yours sincerely

[by e-mail]

Paul Whittaker

UK Director of Regulation

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Appendix 1

Question	NGET Response
CHAPTER: Two	
2.1: 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?	NGET expects that an early OFTO option will be required because it forms the key route to delivering co-ordinated offshore assets. We consider it will be increasingly important to demonstrate a coordinated approach in the planning arenas. As such the early OFTO model should be explored and developed. We look forward to the joint Project Conclusions Report, and the consultation document which will set out the proposed changes to the offshore regime to ensure a coordinated approach is adopted where appropriate for projects with assets that are not just for the use of a sole generator. Further, in our response to Ofgem's consultation on developing a competitive onshore transmission regime we set out our views that the relevant third party TO needs to be responsible for design, consenting, procurement, construction, commissioning, operation and maintenance if the largest benefits to consumers are to be obtained. If the onshore regime can cope with a TO undertaking the entire range of activities in developing new transmission network then, in principle, there should be no reason why this should not also be possible in the offshore regime.
CHAPTER: Three	
3.1: What are your views on the proposed arrangements for triggering a tender exercise?	NGET agrees that where the transmission assets are only required for local works (i.e simple connection solely for his purpose) the developer should make the request for a tender to be run. It should be the developers' responsibility to ensure that this request is made within a timescale that allows the tender exercise to be run and an OFTO to be appointed in line with the delivery of the transmission infrastructure and its contracted connection date. However we do have concerns, that where the development should form part of an integrated co-ordinated solution, then it's essential that the OFTO process should be initiated in a timely manner to ensure both onshore and offshore User requirements can be fully considered.
3.2: What are your views on whether our proposal on generator security will ensure the appropriate level of commitment from a generator?	NGET agrees that there should be incentives on the developer to provide a level of certainty throughout the tender process. However, the 'proportion' they would have to forfeit would be an important factor.

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3.3: Do you agree with our proposed approach to the tender specification for an OFTO build tender exercise?	We agree with Ofgem's proposal but feel greater value may be obtained for the consumer if the early OFTO model remains an option.
3.4: Are the proposed arrangements for pre-construction works the most appropriate for investors and generators?	It will be important that the pre-construction works have been developed with an appropriate degree of input and coordination with the onshore TO and the NETSO and provide a solution on which tenders can be obtained. The developer should certify that the solution identified will operate in accordance with any necessary constraints identified by the TO NETSO and Developer
3.5: 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?	No comment
3.6: 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?	Whilst there may be significant benefits in developing a "standard" detailing the level of detail and information to be provided in sea-bed surveys and the manner in which the survey data will be reported, it should be recognised that each route is unique and if a 'standard' is required to cover all full range of possible conditions, it could result in inefficient costs being occurred at the pre-construction phase. The data should be time stamped and stored in a data room and freely available well in advance of any tender event. The developer should be required to disclose all known conditions in the vicinity of the route identified including a summary analysis of the survey data by a suitably qualified and recognised authority in sea bed analysis. Ideally the report should use this analysis to identify recommended cable burial depths to provide adequate security.
3.7: 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?	
3.8: Do you agree that ensuring procurement is undertaken by the OFTO through the tender process would be the most economic and efficient approach?	Given the limited capacity for offshore networks, particularly with respect to HVDC cables, to ensure availability of cables at the most economic and efficient price more innovative commercial frameworks may be extremely beneficial.
3 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?	We agree that at present there are some potentially significant supply chain constraints. In developing the Western HVDC link it was clear that unless contracts for certain long lead time elements could be placed by a particular deadline then manufacturer capacity would be taken by other projects and a significant project delay could result. We would be happy to discuss our experience with Ofgem on a confidential basis. Removal of supply chain constraints will need the industry to become confident regarding the scale and speed of the government's ambitious offshore renewable generation programme. Sudden policy changes as has recently been seen in relation to solar PV will not help build the confidence needed to invest in additional manufacturing capacity.

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3.10: What are your views on the examples of alternative approaches for supply chain engagement under OFTO build outlined in this section?	We consider that the scope for different approaches to the supply chain should be retained. However we recognise Ofgem's concerns regarding the potential for inefficient behaviour and so it will be important for Ofgem to review the actions taken by OFTOs and ensure that they acted efficiently and where they did not then protect consumers by disallowing inefficiently incurred costs.
3.11: 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?	
3.12: 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?	Any restrictions that might be appropriate are most likely to be between generators and potential OFTOs. NGET would expect to provide the information for which it is responsible on an open, transparent, and non-discriminatory manner. Having said this we would have concerns regarding providing data to a generator operating under the generator build option where that information should normally be available only to a TO due to it relating for example to competitor projects. Outside of that, OFTO's should be free to find suitable partnership arrangements which enable OFGEM's overall target of reducing the costs on behalf of the consumer.
3.13: 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?	We think Ofgem should keep the 20 year revenue duration under review. The key issue to consider in relation to revenue duration is the period over which the assets are likely to be "used and useful" and arguably the best measure of this is the period over which customers are willing to pay for use of the assets. For individual offshore wind farms this appears to be 20 years. There may be situations where assets will be used by wind farms connecting over a number of years (in stages or as separate projects) such that the "used and useful" test implies a life of 25 or 30 years and so it would seem reasonable in such cases to use this longer duration. Given that each element of offshore network is separately assessed and licensed there does not seem to be any requirement for consistency and each case can be assessed on its merits as part of the process of awarding the licence. Where longer revenue streams are considered then it implies that consideration may be needed to be given to equipment replacement mid contract and its financial treatment.

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3.14: What are your views on our proposed treatment of risk relating to: - weather delay?	It is a generally accepted regulatory principle that where parties can manage a risk then they should bear that risk and since there are a number of measures that can be taken to mitigate some of the effects of bad weather we consider that successful bidders should not be totally insulated from this risk. For instance, should a bidder be insulated from weather risk if they schedule installation during periods of the year that are known statistically to be likely to suffer from bad weather rather than more benign? Some installation contractors may be able to respond (at a price) more flexibility to weather windows. The overall installation spread selected can influence the ability of the contractor to continue work in deteriorating weather (again at a cost). Insurance may be available. All of these measures come at some cost but the bidder needs to be incentivised to make efficient decisions rather than simply being able to pass all costs onto the consumer and this means the successful bidder should be exposed to appropriate risk.. The evaluation process must also be normalised to ensure that all bids are considered on a equal footing, and where a bidder is not prepared to take appropriate risk, the value of the risk the consumer is exposed to should be included when determining the total cost of the bid. Where there is a residual risk that cannot be mitigated (e.g. risk of bad weather regardless of the time of year) then there is a case for this residual risk being carried by the consumer. However it would be necessary to carefully and precisely define the circumstances under which the costs of bad weather were transferred to consumers.
3.15: 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?	The staring point for considering this issue should be the approach that is used onshore where TOs are required to manage the vast majority of construction risks. In principle we consider that the arrangements should be consistent and having different regulatory regimes for managing risk for onshore, offshore, or TII projects such as the Western HVDC link is something that should be avoided. One potential area might be "unexpected sea bed conditions". However we would caution against this being included since there are measures that the bidder can take to mitigate for it through the level of detail with which the sea bed survey is undertaken. Any areas of risk which are not carried by the potential OFTO should be supported by a detailed risk evaluation and the full potential costs which could fall on the consumer should be identified and included in the total 'estimated' cost of the project to ensure a fair comparison of all tenders received. We don't consider commodity or supplier costs should be included either as these too can be managed over the relatively short timescales that should normally apply between the tendering process and the final licence award.

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	However, where there is a significant delay to the licence award then there should be scope for a "re-opener" of some sort. Due to the uncertainty over the cause and duration of the delay it may not make sense to have an automatic indexation mechanism as this may fail to address the issues that have changed.
3.16: Is the current approach to recovering bid costs appropriate for OFTO build? If not, what alternative approach to recovering bid costs would you recommend?	No comment
3.17: 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?	No comment
3.18: Do you have any comments on the issues associated with incorporating a refinancing gain share mechanism and how such a mechanism could be structured?	It is a generally accepted regulatory principle that risks should be broadly symmetric. Ofgem's proposal sounds like the re-financing gain share mechanism could also be an ex-post adjustment for the OFTO having managed construction risk successfully and we consider this would not be appropriate. This is because where construction costs over-ran then Ofgem would be unlikely to provide the OFTO with additional revenues and as such the arrangement proposed appears to have the risk of being asymmetric. It is therefore important that the incentive on the OFTO to manage construction risk is not mixed with the incentive on them to finance the project efficiently and so any gain-share mechanism explicitly deals with the financing aspects of the project and does not mix in performance in managing construction risk. Furthermore, it is possible that an OFTO's bid might already reflect its assumptions regarding re-financing post construction and where this is the case then a gain share mechanism risks rewarding the consumer twice for the same benefit. Therefore overall as a point of general regulatory principle we consider that complete clarity ex-ante is needed regarding the arrangements that will apply ex-post in relation to construction performance and to financial efficiency so that the OFTO bid can be appropriately framed. Finally, this question seems based on an assumption that projects will be "project financed" and this may not always be the case – some OFTOs may seek a balance sheet financing approach. Other arrangements may also be possible. The regulatory regime therefore should be sufficiently flexible that it can accommodate any financing arrangements that an OFTO considers is efficient and offers good value.

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3.19: Do you have any preferences from amongst the options outlined for how the PQ stage should operate?	From the NETSO's perspective the key issue is for bidders to fully understand the scope of the role that they will be taking on, in terms of the network design, contractual requirements and obligations, and the ongoing asset management and operational relationships. The PQ process must therefore ensure that it results in the appointment of parties that are fully aware of these responsibilities and the industry codes that will govern them. This will lead to less complicated commercial arrangements and this will result in obtaining better value from the costs associated with NETSO resources.
3.20: 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?	No comment No comment
3.21: Do you have any preferences from the options outlined for how the ITT stage might operate?	
3.22: Are there any other ways that the ITT stage might operate to ensure its efficiency and effectiveness?	No comment
3.23: 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?	No comment
3.24: 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?	For the transitional projects, the NETSO was not involved in the evaluation of bids but did provide some data into the relevant data room, and responded to Clarification Requests raised by bidders via Ofgem. We would expect this support to the process to continue. In terms of OFTO build, there is an expectation that innovation could be achieved through the tender process. Where any such innovation impacts on operation of the NETS it would be essential for the NETSO to be able to comment on the implications and for this information to be taken into consideration by Ofgem. However, it would not be appropriate for the NETSO to be involved in the assessment itself.
***3.25:** Are there areas on which you think allowing variant bids under OFTO build would add value to the process and to consumers?*	See response above, 3.24

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3.26: What are your views on generators recovering efficiently incurred pre-construction costs at the point at which the transmission construction works are completed?	We consider that the starting point for this should be to consider the arrangements onshore and ask why they should be any different offshore. It will be important that there is no scope for generators to include development costs for the generation project within the network pre-construction costs. Where pre-construction costs are to be returned to the generator then this should be covered by the generators financial security arrangements so that if the project subsequently fails to go ahead then these costs can be recovered from the generator from that security rather than falling on consumers (i.e. mirroring onshore arrangements). An alternative might be for the refund to only take place following completion of the project.
3.27: Do you have any early views on the appropriateness of design incentives for transmission asset lifecycle design, eg transmission availability, quality of installation and transmission losses?	We believe developers of offshore transmission should be incentivised to deliver solutions which represent the lowest lifetime cost to consumers consistent with meeting the required standard of asset performance. As noted in our response in relation to competition for onshore transmission we consider that an appropriate availability incentive is important for all network developers / owners. Only with such an incentive can the OFTO (or onshore TO) make efficient and economical decisions regarding, asset design, asset redundancy, strategic spares, maintenance policy etc so as to optimise the planned and unplanned outage costs.
3.28: *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?*	No comment
3.29: *Do you agree that additional delivery incentives for OFTOs are not necessary?*	Any such arrangements need to be thought about carefully, as they could drive perverse incentives (OFTO installs inferior plant quickly as the availability incentive penalty is less than the construction delay penalty). A better approach is to ensure that tender evaluation takes into account realistic timescales and does not advantage bids that appear overly optimistic and have not included appropriate allowances for delay.
3.30: What are your views on what approach to decommissioning of assets would provide best ongoing value to consumers?	The eventual cost of decommissioning should form part of the overall assessment of the lifetime cost of a particular design and so should be reflected in the revenue stream sought by the OFTO. This would be consistent with the approach onshore. If this is not the case then there is a risk that the OFTO design could fail to adequately consider the decommissioning costs and leave the burden of these with consumers rather than being recovered from the customer (through its TNUoS charges) that triggered the network concerned.

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CHAPTER: Four	
4.1: 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?	No comment
4.2: 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?	No comment
4.3: 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?	No comment
4.4: Are there any changes to the information supplied in the data room which would improve the efficiency of the process for Generator build?	Changes to the CUSC put obligations (within the ConsAg) on the developer to provide technical information into the tender process. This information details the transmission equipment that has been installed, and should enable bidders to prepare more informed proposals for the assets they are bidding for.
4.5: What are your views on the benefits of involving generators in evaluation of bids as outlined in this section?	No comment
4.6: 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?	As per response for 4.4, changes to the CUSC puts obligations on the developer to provide technical information into the tender process. NETSO's role in the process for finalisation of transfer documentation is to ensure that developer and OFTO commercial arrangements are in place. The clearer these obligations are throughout the whole generator build process, the greater the efficiency will be in our process, which would maximise value to consumers.
4.7: 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?	In principle we can see that, in the arrangements between the developer and the OFTO, it would make transition from generator to OFTO. Without details at this stage as to how the developer would structure itself and its contracts with NGET to facilitate this, it is difficult to specify any particular concerns but it may be, depending on those arrangements, that the provisions of the Bilateral Connection Agreements etc would need amending to provide for the consequences of this change in role/rather than legal entity.

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4.8: Do you agree that the current split between costs priced into the TRS and those allowed as pass troughs' provides best value for consumers?	No comment
4.9: 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?	No comment
4.10: 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?	No comment

CHAPTER: Five	
5.1: Are you satisfied with the practical relevance of our definition of the terms 'phase' and 'stage'?	We do not disagree with the definitions outlined, however consideration will need to be given to the commitments within individual connection agreements in respect of works expected to be contained within a tender.
5.2: 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?	In line with our response to 5.1, consideration will need to be given to the commercial arrangements within individual connection agreements in respect of works expected to be contained within a tender.
5.3: 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?	The optimum arrangement will be heavily influenced by the timescale and certainty regarding the rollout of further stages / phases. Where these are closer together and more certain then an integrated approach may provide a more efficient and economical solution with limited risk of asset stranding. Where the timescales are longer and future projects less certain then a more incremental approach may reduce the risk of asset stranding and may be more in the interests of consumers. We hope this is an area that Ofgem's forthcoming consultation on integrated development will address and we may be able to make more definitive comments as part of that consultation.