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Date: 17th February 2012

Ofgem Reference: 178/11
Ofgem Publication date: 16/12/2011

Dear Giedre,

Ofgem - Offshore Electricity Transmission: Consultation on tender exercises under the enduring regime[1]

RenewableUK consultation response

RenewableUK is the trade and professional body for the UK wind and marine renewables industries. Formed in 1978, and with over 660 corporate members, RenewableUK is the leading renewable energy trade association in the UK, representing the large majority of the UK's wind, wave, and tidal energy companies. Our members include supply chain companies both manufacturing and services; renewables developers & generators; and energy companies with renewables' portfolios. It follows that not all members necessarily agree with or support the association's response. The association's response aims to represent wind, wave and tidal industries to the best of our ability, aided by the expertise and knowledge of our members.

1 http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?file=Enduring%20con%20doc.pdf&refer=Networks/offtrans/pdc/cdr/Cons2011

Summary

RenewableUK welcomes this consultation and is strongly supportive of the OFTO regime and wants to continue to improve its workability. So far offshore transmission has all been achieved under "generator build". It is vitally important that generator build continues to improve and that Ofgem and industry learn from experiences to date to improve the regime. We welcome this look at OFTO build but we trust Ofgem will next focus on improving, streamlining and reducing barriers and costs for generator build and use the experience to create a successful OFTO build options in future. Immediate issues of concern under generator build include:

- Generators ability to accept coordinated connection offers;
- Risk sharing between generators and OFTOs;
- Commissioning of 132kV assets before handover;
- Valuation of assets and Ofgem's determination of economic and efficient costs;
- Consenting and compulsory powers for transmission assets;
- Lifetime of assets and interactions with transmission charging.

And for OFTO build we would like to see:

- An increased understanding of timescales and ability to achieve Financial Close/ Investment Decision on the generation and transmission assets;
- Greater flexibility in procurement models.

Introduction

We welcome the continuing dialogue with Ofgem to improve the workability of the OFTO regime and that Ofgem have recognised that up to 30GW of offshore transmission capacity is already in the pipeline. RenewableUK expects 18GW of offshore wind to be commissioned by 2020 in addition to wave and tidal generation, much of which will utilise offshore transmission.

Our response is split into 5 sections:

a) Headline point
b) Key issues
c) Responses to Questions
d) Conclusion
e) Annex Feedback Questionnaire

A. Headline point

Generator build first. RenewableUK is strongly supportive of the OFTO regime and wants to continue to improve its workability. Our members have and are developing, supplying, building, owning and operating transmission assets. So far this has all been achieved under "generator build". As an industry we had to fight hard to make sure that generator build remained an enduring option alongside other offshore transmission development opportunities. It is vitally important that generator build continues to improve and that Ofgem learns the lessons from industry's experience to date to improve the regime. We are concerned that the focus of this document leans too much towards OFTO build and that the more immediate issues of generator build may have a lower priority. In our view Ofgem should focus on improving, streamlining and reducing barriers and costs for generator build and use the lessons learned to create a successful OFTO build.

We are also supportive of OFTO build; however, at the moment the challenges for OFTO build are significant. It is vital that OFTO build is based on a successful industry delivering under generator build. Many players and members would like to see OFTO build working as it reduces the finance required to develop offshore generation projects. However, any decision to use OFTO build must be made because OFTO build is more attractive than generator build. Any move to make generator build less attractive will not result in OFTO build but merely delay both the development and the cost savings associated with a growing and increasing competitive industry. By actions such as reducing interest during construction and removing the cost guarantee before specifying what is regarded as cost efficient, Ofgem is risking this detrimental outcome.

B. Key issues

Our key issues are as follows with additional information in the question responses.

1. **Coordinated Connection Offers**. For some months now NGET as NETSO have been making "coordinated offers" where onshore interface points can be moved and where the offshore assets proposed are often in excess of those needed for the specific project and as a result generators are unable to accept the offers as developers are not generally set up to finance construction of wider transmission assets beyond the needs of their project. Unfortunately there is no discussion of this important matter in the consultation; however this important issue needs to be addressed.

2. **OFTO Delay**. Under OFTO build, the risk of late delivery has some impact on the OFTO but a far greater impact on the generator if they are unable to generate on

time. In answer to question 3.29 we have made the point that without stronger incentives on timely delivery any cost savings from the OFTO regime may be considerably outweighed by the increased cost of capital for the generation project (to reflect this risk), or even an inability to finance, due to increased risks of delay. If the assets are late there will be lost generation revenue as well as lost carbon benefits to society. Such outcomes are clearly contrary to the intent of the process and consultation.

3. **Commissioning of >=132kV assets**. Our members are still very concerned that, under generator build, there is no resolution to the issue of commissioning and testing assets (at 132kV and above) prior to handover to an OFTO. Whilst we welcome the assurances in sections 2.18 and 2.19, this matter has been on the table for well over a year and needs speedy resolution.

4. **Valuation of assets under generator build.** We welcome the publication of four specific project cost assessment reports[2] and look forward to the publication of further guidance. We have concerns that legitimate expenditure by generators under generator build to mitigate delay risks and maintain "insurance" options may not (with the additional benefit of hindsight) be considered "economic and efficient" by Ofgem. We are highly concerned with the proposal to remove the cost guarantee (see question 4.6 below). We note Ofgem's recent decision to reduce the interest during construction allowance from 10.8% to 8.5%[3]. We are concerned that these decisions will impact overall project risk and on the cost of capital for offshore generation projects, with knock-on effects on costs to customers.

5. **Consenting and compulsory powers**. Under the old regime generators have powers under their generation licence to secure necessary wayleaves or compulsory purchase powers to complete their connection to existing (onshore) assets. Under the new regime their generation licence powers only extend to the offshore connection point not the onshore interface point. New powers are available under the IPC process but these power are untested and do not apply in Scotland or to onshore substations in Wales. We welcome the statement[4] that this issue is being addressed with DECC.

6. **TNUOS charges and 20 year asset life**. At present TNUOS charges are based on a cost recovery period of 20 years. If asset lives are longer that this, as expected, the

[2] Paras 4.19- 4.22.
[3] Interest during construction
http://www.ofgem.gov.uk/Pages/MoreInformation.aspx?docid=28&refer=Networks/offtrans/pdc/cdr/Cons2011

generators may have been overcharged unless their TNUOS charges are adjusted. We are not aware of any proposals or methodology in TNUOS charging to accommodate such life extensions. We will review this issue with others relating to coordination and charging.

7. **Financial Close**. Financial Close / Final Investment Decision (FID) / Financial Decision for the generator projects is completely absent from the discussion except within Chapter 5. No process is complete without a thorough discussion of how FID is completed and how it impacts on program and specifically the ability to place orders on suppliers for plant.

8. **Undue focus on one off Competitive Tendering to procure OFTO assets**. In section 3 Ofgem has assumed and is acting to ensure a very narrow model for the procurement of OFTO assets, i.e. that OFTOs procure each asset on a one off basis by competitive tender. There are two reasons why customers would benefit from a less prescriptive approach that allowed the industry to develop a variety of models:
    - It is imperative that developers can and do 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 requirements, costs, risks and timescales.
    - For complex, multi-disciplinary, design and construction contracts the experience of other industries is that these more collaborative approaches to procurement result in better project outcomes including lower overall costs than simple lowest-fixed-price-wins tenders.

- We expand on these points in response to specific questions below.

C. Consultation Questions

CHAPTER: Two sets out the objectives and overview of the enduring regulatory regime for offshore electricity transmission

Question 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?

Ofgem should focus on ironing out the final issues for Generator Build and this knowledge and experience will help with OFTO build. We agree that Ofgem should not delay the other two options by spending time or focus on "Early OFTO Build" just yet.

[4] Para 3.17.

However Early OFTO Build could play a role in delivering co-ordinated offshore assets in the medium term and should be explored in that context in the forthcoming coordination consultation. Also, in resolving some of the challenges under Generator Build and Late OFTO Build it may sometimes be helpful to consider if an Early OFTO build might resolve the issue.

CHAPTER: Three sets out our proposed framework for the OFTO build option

Question 3.1: What are your views on the proposed arrangements for triggering a tender exercise?

We understand the 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"[5]

Therefore the consultation does not address a key current issue which is how generator and OFTO build can operate under "coordinated offers".

Question 3.2: What are your views on whether our proposal on generator security will ensure the appropriate level of commitment from a generator?

A security seems reasonable, however a generator may wish to pull back from an OFTO build after the tender if they consider the price is too high or if they can build it at lower cost, or if the price (i.e. too low) or preferred bidders' experience indicate that the risks of OFTO build are too great.

Question 3.3: Do you agree with our proposed approach to the tender specification for an OFTO build tender exercise?

You state that:

> "The bilateral connection agreement will specify the anticipated connection point and interface point"[6]

However the bilateral connection agreement allows NGET to flex the anticipated interface point. Therefore the tender cannot specify this point absolutely.

Question 3.4: Are the proposed arrangements for pre-construction works the most appropriate for investors and generators?

We are pleased to note your statement:

> "We are aware of generator concerns on the extent to which they are able to take advantage of compulsory purchase and wayleave powers and we are working with DECC to provide clarity on this issue in early 2012."

[5] Consultation 178/11 para 3.8.
[6] Para 3.14.

This is a significant issue for generators under the enduring regime and we look forward to a satisfactory resolution.

The planning process may impose conditions which take time to resolve and are likely to be an interface issue between the generator (as original consents applicant) and the OFTO as construction party.

Question 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

Question 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?

We are concerned that this kind of detail may result in "over-regulation" of the process.

Bidders' confidence in the data will depend only 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. It may be helpful to consider if generators want to be available for questioning about this and other data.

Question 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?

Even if a standard independent generic survey specification were produced, it does not guarantee that the survey will in all respects conform to the specification. This may not be evident until the data has been passed to OFTOs or perhaps until construction. The question of compliance to specification and liability and warranties for the survey data then arises. The surveyor will undoubtedly not accept liabilities up to the level of the risk taken by the OFTO in acting on that survey data.

Question 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?

It is imperative that developers can and do 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 requirements, costs, risks and timescales.

Developers must be able to secure contracts with suppliers and book factory slots if they so wish in order to meet timescales and the regime should accommodate these arrangements.

Question 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?

There is always a trade off between timescales and price, especially in an expanding market with supply chain bottlenecks which characterises offshore transmission using both AC and DC technologies.

Question 3.10: What are your views on the examples of alternative approaches for supply chain engagement under OFTO build outlined in this section?

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. It would therefore seem perfectly reasonable to have similar arrangements in relation to OFTOs. The objections raised in the consultation[7] can be overcome.

Question 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?

It imperative that developers can and do 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 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. For complex, multi-disciplinary, design and construction contracts the experience of other industries is that these more collaborative approaches to procurement result in better project outcomes including lower overall costs than simple lowest-fixed-price-wins tenders. We are convinced that UK electricity customers will be served better by allowing the industry the flexibility to develop a range of contracting models, rather than imposing a single narrow model.

Question 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?

There should not be any restrictions on the interactions between parties as this will inhibit innovation and cost reductions and also increase risks and costs for the parties with a detrimental knock on impact on consumers.

Question 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?

In our view many assets will have a lifetime in excess of 20 years and if this lifetime can be exploited to lower costs we would welcome that. The link to this additional lifetime and transmission (TNUOS) charges is also an important point we have covered in our headline response.

Question 3.14: What are your views on our proposed treatment of risk relating to:
- delay to licence grant?

[7] Para 3.29.

- weather delay?

In our members' experience weather delays are highly complex to monitor and specify. Weather risks can be mitigated by use of relevant plant and vessels. We would not recommend predetermining risk sharing for weather delays as this will vary from contract to contract.

Question 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?

One of the biggest risks to the generator is delay by the OFTO. Any proposals to allow delays are only acceptable if all the costs of delay are removed from the generator. If the generator carries such risks then the ability of the generator to choose OFTO build will be further limited.

Question 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.

Question 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

Question 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?

Refinancing is more important under OFTO build as many forms of finance cannot accept construction risks. Any refinancing gain share may reduce the number of bidders and/or push up bid prices. It is up to Ofgem to judge the optimum balance to secure best value for the consumer.

Question 3.19: Do you have any preferences from amongst the options outlined for how the PQ stage should operate?

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 must judge the balance of its administration costs with the benefits of additional bidders and competition.

Question 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

Question 3.21: Do you have any preferences from the options outlined for how the ITT stage might operate?

The ITT process outlined in the consultation and shown in diagram 3 is incomplete. The IPC process does not apply in Scotland and does not apply

to onshore substations in Wales – therefore different processes are required.

Question 3.22: Are there any other ways that the ITT stage might operate to ensure its efficiency and effectiveness?

No comment

Question 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?

In our view if generators want to be involved in bid evaluation they should be encouraged and enabled to do so and that they should be able to request any relevant data they consider important.

Question 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?

In our view the NETSO does not need to be involved in the evaluation of tenders. STC and Grid Code compliance are specified and so are clear. Regardless of any tender assessments, there is always the risk that the assets do not completely meet the specifications once commissioned and tested and it may not be possible to rectify provide that compliance. Ofgem should focus on having a procedure in place to deal with such circumstances rather than adding more complexity to the tender assessments. If Ofgem did decide that the NETSO should be involved their involvement should not be any greater.

Question 3.25: Are there areas on which you think allowing variant bids under OFTO build would add value to the process and to consumers?

An example of variant bid may be the choice of HVDC voltage. The generator may specify a tried and tested HVDC voltage (e.g. 300kV) whereas the OFTO may propose a new voltage (e.g.400kV) which may have advantages of lower costs and losses, but has higher risks as newer technology. The generator should have the right to veto such variations if the risks are unacceptable to their project. Without such a right to a veto there is a risk that the generator may not achieve project finance.

Question 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 see no reason why efficiently incurred pre-construction costs should not be recovered immediately. They should not have to wait until construction works are completed. This would align generators (who are acting as offshore TOs) with onshore TOs in this respect.

We note the proposal[8] not to compensate generators if their planning application is turned down. In our view this is totally unacceptable and is adding a financial penalty to other costs of delay, appeal and reapplication

[8] Para 3.87

faced by the generator. We are not aware of any similar approach taken for onshore TOs.

Question 3.27: 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?

The issue of transmission availability is extremely important and the incentives must contribute to encouraging the repair of any fault regardless of how long the fault has been sustained. We wish to see a sharpening of the availability incentive to produce a more equal apportionment of risk between the generator and the OFTO. This could be facilitated by further clarification of the OFTO of last resort process and clarification of the mechanism for the revocation of the OFTO licence.

Electrical transmission losses are important in the design but losses should also be compared to unavailability. Over a 20 year lifetime, a significant loss improvement of 1% is still less lost energy that a single outage of 3 months.

Question 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

Question 3.29: Do you agree that additional delivery incentives for OFTOs are not necessary?

Additional incentives are certainly needed 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. Such an outcome is clearly not in line with the objective of the document – driving down offshore generation costs.

Any LDs need to be paid to the generator (whether that is directly or indirectly via the NETSO).

Question 3.30: What are your views on what approach to decommissioning of assets would provide best ongoing value to consumers?

The complex and important issues of:

- the risk of major failures in the final years of a franchise;
- decommissioning;
- residual value.

need greater analysis and discussion and we look forward to the further consultation in the spring of 2012.

CHAPTER: Four sets out our proposed framework for the Generator build option

Question 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?

The relevant survey in this instance would be a post installation survey. The same point arises in relation to question 3.6. i.e. the bidders' confidence in the data will depends only 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.

We note that the subsea export cable seems to be the major focus area of the risk averse OFTOs. However it is not the preconstruction survey which is their real concern, but the burial and the burial assessment. An industry agreed methodology on how to assess necessary protection of an export cable may add value and save costs, subject to the comments in 3.6 above regarding quality and liabilities.

Question 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?

Tenders should be run at the most appropriate time for the project in question otherwise excessive bid premiums will be included i.e. Tender rounds should be flexible and as frequent as necessary to meet generators' critical paths and deliver more offshore renewables, more cost effectively.

Question 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

Question 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?

No comment

Question 4.5: What are your views on the benefits of involving generators in evaluation of bids as outlined in this section?

Same answer as in Question 3.23 above. In our view, if generators want to be involved in bid evaluation they should be encouraged and enabled to do so and they should be able to request any relevant data they consider important.

Question 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?

Because there is no clear view on what Ofgem will consider economic and efficient costs we note with concern the statement that:

> "we will not provide generators with a cost guarantee for Generator build tender exercises under the enduring regime"

We would like to see economic and efficient costs clearly defined and understood to reduce concerns about cost guarantees.

This position puts additional risk on generators and increases the considerable development and cost risks they face already. The result will be to increase the cost of capital which is not in line with the stated outcome of the document i.e.

> "drive down costs of offshore wind, reduce costs to consumers and help achieve government's low carbon targets"

Question 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?

No comment

Question 4.8: Do you agree that the current split between costs priced into the TRS and those allowed as pass through provides best value for consumers?

No comment

Question 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

Question 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?

Similar answer as in Question3.18. The generator should benefit from any such refinancing to incentivise them to assist in that process. Although any refinancing gain share may reduce the number of bidders and/or push up bid prices. It is up to Ofgem to judge the optimum balance to secure best value for the consumer.

CHAPTER: Five considers transmission assets within Crown Estate sites or zones that are likely to be constructed in phases and/or stages

Question 5.1: Are you satisfied with the practical relevance of our definition of the terms 'phase' and 'stage'?

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

Question 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?

Affected generators should have a strong say in whether assets will be tendered separately or together. It is not clear to us how this operates in the development of a R2/3 phased project or a large R3 zone. There appears to be an underlying assumption at Ofgem that each project financial close should mean a separate OFTO process which may not be what developers were anticipating. This is a key area for detailed discussion on a project specific basis with Ofgem as soon as possible.

The process is more complex and with coordinated offshore grid and needs further discussion.

Question 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?

Affected generators should have a strong say in whether phases will be tendered separately or together.

D. Conclusion

We look forward to the feedback on our response and welcome further engagement with OFGEM in these matters and look forward to working together with our members to improve the operation of the OFTO regime

"to help realise investment in offshore transmission, drive down costs of offshore wind, reduce costs to consumers and help achieve government's low carbon targets".

Yours sincerely,

Guy Nicholson; Head of Grid for RenewableUK,

Enc.

Annex 1 -Ofgem's feedback questionnaire

Annex 1 - Ofgem's feedback questionnaire

Ofgem considers that consultation is at the heart of good policy development. We are keen to consider any comments or complaints about the manner in which this consultation has been conducted. In any case we would be keen to get your answers to the following questions:

1. Do you have any comments about the overall process, which was adopted for this consultation?

The workshop on the 9th February was very helpful. Next time we request that such workshops are held before the last 2 weeks of the consultation to give more time to incorporate the views and information.

2. Do you have any comments about the overall tone and content of the report?

The report should have put increased focus on improving the better understood "generator build" model which will feed into facilitating OFTO build in the future.

3. Was the report easy to read and understand, could it have been better written?

Generally well written.

4. To what extent did the report's conclusions provide a balanced view?

We have concerns that risks are transferred from the transmission owner to the generator/developer. Cost savings in transmission could be offset by additional costs in generation (e.g. through increased cost of capital due to increased risks). As the generation investment is typically some 4 to 8 times the transmission investment this effect could be significant. However, there is no evidence of analysis of this effect.

5. To what extent did the report make reasoned recommendations for improvement?

No comment

6. Please add any further comments.

No comment

Please send your comments to:
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