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17 February 2012

Dear Giedre,

**Response to Consultation on Tender Exercise under the Enduring Regime**

Transmission Capital is a leader in the offshore transmission sector with three OFTOs under management and a fourth at the preferred bidder stage. We are bidding currently in transitional round 2 and we expect to be involved in the enduring regime tender exercises from the start.

We welcome the opportunity to respond to this consultation, which will help set the rules for the creation of a £15bn offshore transmission industry over the next decade, and should also be the basis for the wider use of competitive transmission in the development of the British grid. We are particularly pleased to see the importance Ofgem attaches to defining the OFTO-build model, as we believe that our skills will allow us to deliver considerable cost savings through this mechanism. Ultimately this will drive down costs to consumers and help to achieve the UK's low carbon targets.

We have set out in the following pages our response to each of your questions. Please note that for a handful of the questions our responses are confidential: we provide these in a separate confidential responses annex.

If you have any queries about these responses please do not hesitate to contact me.

Yours sincerely

**Sean Kelly**
Director

# Response to Specific Questions – Chapter 2

***Q 2.1 – Focus on late OFTO appointment****: 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?*

We agree that Ofgem's focus should be on a single OFTO build option at this stage, and that this should be the "late OFTO build option".

# Response to Specific Questions – Chapter 3

***Q 3.1 – Triggering tender process****: What are your views on the proposed arrangements for triggering a tender exercise?*

It is unclear to us why it isn't possible for the generator to be given the flexibility to trigger the process, providing they understand the timescales implications and the OFTO bidders are protected from abortive bidding costs (see response to Q3.2 below).

The suggestion that the tender process should be triggered at least 3 months prior to the expected consent application date is workable, but it might perhaps be more logical to have the start of the tender process linked in some way to the desired connection date, and/or the project financial commitment date, or (as suggested above) for it to be decided by the generator.

***Q 3.2 – Generator Security****: What are your views on whether our proposal on generator security will ensure the appropriate level of commitment from a generator?*

We agree that arrangements should be based on the current transitional arrangements, however the larger bid costs faced by OFTOs in an OFTO-build environment are substantially greater than those found in the transitional regime and we believe that a mechanism to reimburse bidders should the generator withdraw should therefore be included. (See also our response to Q3.16).

***Q 3.3 – Tender Specification****: Do you agree with our proposed approach to the tender specification for an OFTO build tender exercise?*

We agree that the connection agreement, consents application and any pre-construction works should form the basis of the high level design.

Ofgem should clarify whether the "high level design requirements" to be provided by the generator (paragraph 3.13), refers to documents written by the generator that would be part of the tender spec (along with the connection agreement, consents application, and pre-construction works) and setting out an explicit set of generator requirements.

Ofgem should also clarify if/how generators can specify any reliability requirements in excess of those set out in the SQSS (for instance if generators would rather have a pair of half-size circuits rather than a single larger circuit).

***Q 3.4 – Pre-Construction Works****: Are the proposed arrangements for pre-construction works the most appropriate for investors and generators?*

We agree that the proposed arrangements for pre-construction works are appropriate.

***Q 3.5 – Data Room****: 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?*

Other information required in the data room includes:

- Electrical data for the onshore grid and the generator's systems (this may need to include highly technical data such as harmonic impedances).
- Any requirements for generator and NETSO equipment on offshore platforms and in onshore substations.
- Quotes from the relevant onshore TO for connection to their assets.
- Any requirements from the generator for services and facilities to be provided to generator by OFTO (e.g. auxiliary electricity supplies, fibre optic channels, workshop / helipad / emergency refuge on substation platform).

- Engineering surveys (see below).
- TOCA terms from NETSO including any delay LD requirements.

***Q 3.6 – Seabed Survey****: 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 think that the generator should have an obligation to procure surveys of the proposed onshore and offshore cable routes and the onshore and offshore substation locations. These surveys should be carried out by reputable survey contractors and each survey contractor should provide reliance on the factual accuracy of the survey, backed up by a suitable level of professional indemnity insurance.

We note that it is frequent practice in the industry to undertake only a high level subsea survey to check the feasibility of route prior to consent application, and to leave the detailed survey necessary to provide cost certainty until after consents approval – or even until after contractor appointment. In the light of this we think that in most cases it will be necessary to provide a mechanism whereby the tariffs charges by the OFTO can be adjusted ("TRS adjustment") should ground conditions differ materially from those indicated by the survey.

***Q 3.7 – Independent Generic Survey Spec****: 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?*

We believe that an unambiguous and truly generic survey specification will be very difficult to produce as factors such as the distance between CPT (cone penetrometer test) points is inherently a function of the variability and complexity of the seabed, and this level of complexity will be site specific – indeed sometimes it will not be fully known until after the survey is complete, or even after the cable burial works are complete.

Possible approaches include:

- Ofgem selecting a panel of independent consultants to provide survey specifications for generators on a project-by-project basis.
- Creating a set of generic principles that are then interpreted to create project-specific specifications.
- Asking potential bidders could be asked to comment on the generator's project-specific specifications before they are finalised (if the timescales are right).

However none of these approaches can be expected to entirely eliminate the issue and some risk sharing arrangements to deal with residual ground condition risk may ultimately be necessary.

***Q 3.8 – Supply Chain and Procurement:*** *Do you agree that ensuring procurement is undertaken by the OFTO through the tender process would be the most economic and efficient approach?*

We firmly support Ofgem's view that the OFTO should carry out all procurement through the tender process.

***Q 3.9 – Supply Chain Lead Times:*** *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?*

The current situation is that lead times vary from less than two years for small AC systems to four years for large DC systems. However the current situation may not be a good guide to the future situation, given that we have recently seen:

- The number of offshore high voltage cable suppliers in the European market increase from 3 to 5.

- One of largest offshore cable manufacturers announcing a doubling of capacity.
- The number of VSC converter manufacturers increasing from 2 to 3.
- The apparent ending of the rapid rollout of new wind farm connections in Germany following the reported difficulties encountered by TenneT.

At this stage, therefore, it is only possible to state that there may be constraints and that these may well be dependent on the design adopted. We believe that it is premature to seek to adapt the tender process on the basis of possible constraints that may not materialise, or which may materialise and a different and unexpected form.

***Q 3.10 – Alternative Supply Chain Approaches:*** *What are your views on the examples of alternative approaches for supply chain engagement under OFTO build outlined in this section? Also Q 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?*

We remain very concerned that any of the proposed approaches – even the non-binding reservations – may skew the bid process by making one design, one contract form, or one financing solution the only deliverable solution in the timescale available. If they are to be used at all it should only be under close Ofgem supervision to ensure that an unfair advantage isn't given to a particular bidder (e.g. because one bidder has a pre-existing or exclusive relationship with the supplier already selected by the generator).

***Q 3.12 – Interactions between Parties:*** *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?*

TCP considers that once the tender process has commenced, there should be no contact (unless managed by Ofgem as per the transitional regime) between the generator and any of the bidder consortia in relation to the project being tendered. This prohibition should include indirect contacts (e.g. via suppliers).

Before the tender process has commenced such contacts are acceptable, and indeed may be advantageous.

***Q 3.13 – 20-year Revenue Stream:*** *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 consider that a 20 year revenue stream will continue to provide best value to the consumer. For example it is not possible at the time of bidding to tell whether the offshore wind farm will be life extended or replanted post year 20. It would also be very difficult for OFTO bidders to be asked to bid firm prices in respect of O&M, insurance and asset replacement (which will be required for some systems post year 20) for periods out beyond year 20. If OFTO bidders are forced to take these unquantifiable risks they are likely to respond by adding substantially larger risk margins to their bids. Ultimately this will increase costs to consumers.

If it wished to reduce 20-year tariffs by taking advantage of the likelihood that at least some projects would have a longer operational life, we suggest that this be done by Ofgem maintaining a 20-year revenue period but also setting a residual value of the assets in year 20. Ofgem would provide an assurance that after year 20 the OFTO's income would be set to ensure that the company earns a reasonable rate of return on its regulatory asset value (RAV); the opening (i.e. year 20) value of this RAV would be the residual value originally set by Ofgem as a bid condition.

***Q 3.14 – Licence delay and weather risk:*** *What are your views on our proposed treatment of risk relating to (i) delay to licence grant, (ii) weather delay*

The approach dealing with licence grant delays seems sensible, though we note that:

- It will not always be possible for costs to be "indexed" to a simple numerical index in situations where the manufacturers offer validity period has expired. Once the offer has expired the manufacturer may assign factory capacity to another project and be unable to meet the OFTO's requirements. In the worst case the OFTO may need to re-tender part of the works. We assume that in such cases, where the delay is not the OFTO's fault, it will be possible to adjust tariffs through a "TRS adjustment" process.
- Manufacturers will resist giving long offer validity periods (to avoid restricting their ability to make offers to others) and so Ofgem's planned process for tender assessment will need to be suitably rapid.

The approach to weather delay appears workable, providing Ofgem can provide bidders with a clear formula for weighting bids by the number of allowable days and the cost-sharing factor proposed.

Ofgem should also discuss what happens if the project's connection date slips after bids have been submitted – we presume that this would be dealt with through a variant of the "TRS adjustment" approach used for transitional-regime OFTOs.

***Q 3.15 – Risk Sharing:*** *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?*

We consider that bidders should be asked to bid based on assumed reference prices of some metals (e.g. copper) and forex rates, with the "market rate adjustment" term in the licence allowing the OFTO's charges to be altered based on differences between these assumed values and the actual values at licence award/financial close (at which point these prices can be hedged)

This extends the approach currently taken in respect of interest rates and RPI swap rates in the transitional regime. Also we believe this mechanism has been used in rolling stock PPP procurements where there is a significant exposure to metal prices that cannot be effectively managed prior to contract award.

***Q 3.16 – Bid Cost Recovery:*** *Is the current approach to recovering bid costs appropriate for OFTO build? If not, what alternative approach to recovering bid costs would you recommend?*

We agree that bidders who submit a tender, or are unable to do so as a result of the tender being cancelled, should be reimbursed their bid costs. We consider that in order to provide the correct incentive to bidders this should be a fixed amount set out prior to the tender process commencement.

***Q 3.17 – Access to Finance:*** *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?*

(See confidential annex)

***Q 3.18 – Refinancing*** *Do you have any comments on the issues associated with incorporating a refinancing gain share mechanism and how such a mechanism could be structured?*

(See confidential annex)

***Q 3.19 – PQ Stage*** *Do you have any preferences from amongst the options outlined for how the PQ stage should operate? Q3.20 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?*

We believe that there should be annual (or "as requested by prospective bidder") PQ processes, but the validity period of pre-qualification should be increased to three or more years, with any material changes being confirmed to Ofgem if and when they occur. This extended pre-qualification validity should also apply to parties that have already been pre-qualified under the transitional process.

This would reduce the administrative burden on Ofgem and OFTO bidders whilst not preventing new entrants from entering the process.

***Q 3.21 – ITT Stage*** *Do you have any preferences from the options outlined for how the ITT stage might operate? Q3.22 - Are there any other ways that the ITT stage might operate to ensure its efficiency and effectiveness?*

Option 1 (consent granted during ITT phase) and option 2 (consent granted before preferred bidder announced) look acceptable, but we feel that option 3 (split technical and financial ITT stages) is undesirable as the complex and would increase bidders' costs significantly without accelerating or de-risking the process.

We consider that Ofgem should retain the flexibility as to the precise timing of the tender process (i.e. between option 1 and option 2), in discussion with the generator.

***Q 3.23 – Generators evaluating bids:*** *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?*

We consider that the generator should not be involved in any way in the evaluation of bids. The generator should have set out, prior to the start of the ITT process, all of its requirements for OFTO bidders. Ofgem and its consultants should then verify that these requirements have been met. There is no need for generators to be involved and it could cause a potential conflict of interest – for example, anonymity cannot always be ensured as designs may clearly indicate a particular supplier who may be part of a particular bidding consortium.

***Q 3.24 – NETSO evaluating bids:*** *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?*

We have very strong reservations about NETSO having any role in the evaluation of bids. Chinese walls are not always effective and it is highly likely that a National Grid subsidiary will be bidding for some of the projects. We consider that Ofgem should be able to appoint consultants to answer any technical questions in relation to compliance with SQSS, STC, Grid Code compliance etc.

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

We are a little unsure as to what is meant by a "variant bid on selected elements within the scope of the tender specification" – we would consider that a bid that is entirely compliant with the specification is not a variant bid. We do not consider that bids that do not meet the tender specification should be allowed.

It is possible that options (i.e. two alternative specifications) should be allowed in the bid process but bidders should have clarity on how these options will be assessed and compared to each other so that they can be priced accordingly.

***Q 3.26 – pre-construction costs:*** *What are your views on generators recovering efficiently incurred pre-construction costs at the point at which the transmission construction works are completed?*

We agree this is a sensible approach and that the completion of construction works is the correct time for cost recovery.

***Q 3.27 – Asset Lifecycle Design:*** *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 agree that the transmission availability incentive should be retained and that it should remain largely in its current form.

We do not understand the rationale for a 'quality of installation' incentive as the OFTO has all the incentives it needs in this respect through a fixed income, the availability incentive and the need to comply with relevant laws, codes etc.

We think a losses incentive should be implemented – and for this to work properly it is important that OFTO bidders have access to unambiguous formulae for:

- Converting design losses into an amount that will weight the TRS bid.
- Converting variations between design and actual losses into incentive payments/charges to the OFTO.

***Q 3.28 – Indexation:*** *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?*

The current indexation arrangements are attractive to investors and therefore provide value for money to consumers through reduced cost of capital.

Arguably the inflation risk facing consumers is best dealt with through RPI indexation of OFTO tariffs: with this approach consumers are naturally hedged as their incomes will tend to rise at the same rate as the OFTO-tariff part of their electricity bills. Without RPI indexation the OFTO bidders will need to take a view (probably conservative) on inflation and bid accordingly. If this level of inflation does not occur then consumers will suffer the extra cost of assumed inflation without compensating increases in incomes.

***Q 3.29 – Delivery Incentives:*** *Do you agree that additional delivery incentives for OFTOs are not necessary?*

We agree that no additional delivery incentive are necessary for OFTOs and we consider that it would be difficult for OFTO bidders to price this, as it is expected that delay LDs available from contractors will largely go to pay interest costs during construction in the event of delay.

However, we do consider that government and/or Ofgem should develop proposals that mitigate lateness in delivery under the OFTO-build model as our concern is that if this is not done the barriers for a generator opting for OFTO-build will be too high. These arrangements could be time limited as our view is that confidence in OFTO delivery would be established fairly quickly after the first few projects had been constructed by OFTOs.

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

If there is to be a residual value at year 20 (see our response to Q3.13) then it would seem unreasonable that the OFTO would still be expected to make financial provision for decommissioning at the end of this year. We note, though, that this is likely to be a matter for decision by DECC (under the Energy Act's decommissioning provisions) rather than Ofgem.

# Response to Specific Questions – Chapter 4

***Q 4.1 – Seabed Survey Standards:*** *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?*

It is not clear under the generator build option whether export cables would have been laid at the time of bid (these have varied from project to project – and even within a project – for the transitional projects).

A generic specification might help with the execution of the post-lay depth of burial survey, although most problems with such surveys tend to arise from their implementation and interpretation rather than their specification.

We also note that OFTO due diligence acceptance of cable burial conditions will also require an analysis of seabed mobility (which may draw on pre-construction surveys) and risks so that the required burial depths can be calculated.

***Q 4.2 – Project Grouping:*** *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?*

We agree that there should be tender rounds for groups of projects but it would reduce bidding costs if each tender within a round is run to the same timescales (i.e. same tender start and bid dates), there are not overlapping tender stages (i.e. one starts before another finishes) and there are no slippages to the tender programmes. Tender round 1 was a much more efficient process than the first two projects in tender round 2A.

***Q 4.3 – Tendering Process Efficiency:*** *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?*

(See the confidential annex)

***Q 4.4 – Data Room:*** *Are there any changes to the information supplied in the data room which would improve the efficiency of the process for Generator build?*

In general our concerns relate more to data that is provided late (see Q4.3) rather than missing data. We do suggests that Ofgem provides the detailed cost breakdowns (e.g. the "Grant Thornton report") on all projects; to date these have only been made available once.

***Q 4.5 – Generators Evaluating Bids:*** *What are your views on the benefits of involving generators in evaluation of bids as outlined in this section?*

We do not agree that generators should be involved in evaluating bids. This has not been necessary in the transitional tender round and adding it to the enduring generator-build regime would only add complexity and could lead to concerns over whether a generator is seeking to unduly influence the outcome.

***Q 4.6 – Transfer Efficiency:*** *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?*

(See the confidential annex)

***Q 4.7 – Share Sale v Asset Transfer:*** *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 share-sale approach should be easier with respect to land rights, although some projects have shown that this can be managed by tying cable easements to substation leases.

Possible disadvantages of the share-sale approach include:

- It may be harder to undertake due diligence to uncover all possible liabilities within the company being sold.
- There may be situations where the OFTO cannot accept certain liabilities within the company being sold, or the generator cannot accept the loss of certain rights that have been vested with the company being sold.
- There may be more significant TUPE considerations.
- Contracts may need to be split prior to the sale of the shares as packages of works are not always neatly divided into wind farm/transmission assets.

The tax treatment in relation to the availability of capital allowances may also be different.

***Q 4.8 – TRS Costs v Pass Through:*** *Do you agree that the current split between costs priced into the TRS and those allowed as pass-throughs provides best value for consumers?*

We agree with the current split of between costs priced into the TRS and those allowed as pass-throughs, and we believe that it provides the best value for consumers.

***Q 4.9 – Access to finance:*** *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?*

We believe that neither the current arrangements, nor the proposed changes, will unreasonably restrict access to finance.

***Q 4.10 – Refinancing Gain:*** *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?*

We do not consider that a refinancing claw back is sensible or efficient for the generator build option. The absence of construction risk on the OFTO bidders makes refinancing upside much less likely to be significant. See also our response 3.18 above.

# Response to Specific Questions – Chapter 5

***Q 5.1 – Phase and Stage Definition:*** *Are you satisfied with the practical relevance of our definition of the terms 'phase' and 'stage'?*

We would like to see the definitions of "phase" and "stage" clarified.

Our understanding of your proposal is that each Final Investment Decision (FID) is associated with a phase (e.g. London Array = 2 phases) whilst a set of assets built under a single FID, but handed over at different times to is multiple stages.

Other examples (e.g. Sheringham or Walney) would be very helpful.

***Q 5.2 – Phase and Stage OFTOs:*** *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? And* ***Q5.3:*** *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?*

As noted above there is a degree of uncertainty in our understanding of "phase" and "stage". As we understand your proposals there would be one OFTO for each set of assets associated with a single FID. This arrangement appears reasonable, but we would appreciate if it could be clarified with examples.