

## BY EMAIL ONLY

Martin Crouch  
Director, Offshore Transmission  
Ofgem  
9 Millbank  
London  
SW1P 3GE

20<sup>th</sup> September 2012

Dear Martin

### **Response to open letter: Offshore Transmission – update on Coordination policy developments**

We welcome the opportunity to provide further input into the development of policy to ensure a co-ordinated offshore grid. We have restricted our response to the questions set out on page 5 of the open letter, in relation to Investment Category 3 works (wider network benefits investment not taken forward by a developer). Following our discussions with Ofgem we understand that there is expected only to be a very limited number of projects in this category (e.g. inter-zonal links), at least in the period to 2020.

The key points in our response are:

1. Ofgem should clearly define what transmission projects will fall under either an offshore or onshore competitive tender process;
2. NETSO should be responsible for transmission system planning but we would expect the onshore TOs to have the resources, skills and experience to carry out the pre-construction works;
3. The timescales for carrying out the pre-construction works must enable the OFTO tender process to be run – all offshore transmission assets should go through an OFTO tender process: post construction if built by a generator; pre-construction if not.
4. Affiliates of onshore TOs should either not be allowed to tender for works the onshore TO has developed, or much stronger business separation arrangements should be mandated than are currently in place.
5. Outputs from the pre-construction works should essentially be the same as for an OFTO build tender process where the generator has carried out the development.

We answer the specific questions below.

***Whether the NETSO could have a role in identifying and undertaking the pre-construction works, instead of or in addition to TOs having such a role.***

#### Transmission System Planning

In the response to this question we refer to transmission system planning as the activity required in order to determine the topology and size of new or changed

elements of the national electricity transmission system in order to comply with national electricity transmission System Security and Quality of Supply Standards.

In Scotland, transmission system planning is undertaken by the two onshore transmission licensees (SPT and SHETL), whilst in England & Wales it is undertaken by National Grid in its role as NETSO.

The co-ordination project is seeking to exploit advantages through better co-ordination of transmission planning onshore and offshore. As such it seems most sensible that the party responsible for onshore planning in a particular area should take a lead in planning the offshore grid that may connect to it. This may require the collaboration between two or more parties where developments cross boundaries between onshore TOs.

However, in our view a preferable alternative would be for NETSO to be given the responsibility for transmission system planning across the entire onshore and offshore system. This would have the benefit of ensuring a single optimised design taking account of all implications on the wider system.

#### Identifying and carrying out pre-construction works

In general we believe that transmission system planning is unlikely to give rise to many business separation issues. The one exception to this may be that if carried out by an onshore TO (or an affiliate of an onshore TO) there may be incentives to bias transmission expansion, through the planning activity, either towards onshore works (to increase the onshore TO's asset base or reduce the scope for competition in the provision of transmission) or towards offshore works (if for example the onshore TO is capially constrained).

However, identifying and carrying out pre-construction works has greater scope to give rise to business separation issues. The party identifying and carrying out pre-construction works could:

- Restrict the number of available equipment suppliers
- Affect the risk profile of the investment opportunity for offshore transmission and therefore the availability and cost of sources of finance
- Affect the timing of an OFTO tender round, and perhaps even the ability of an OFTO tender to be conducted whilst still meeting developer timescales
- Gain access to project information that could be valuable in pricing an OFTO tender.

Onshore TOs are already prevented from taking part in OFTO tender rounds and to date the only affiliate of an onshore TO that has taken part (National Grid Offshore) has rightly had to do so with business separation arrangements in place. We believe that these business separation arrangements should either prevent an OFTO bidder affiliate of a party that has carried out pre-construction works from bidding to construct the works, or should be significantly strengthened in many respects (we detail this further below).

We would question whether NETSO has the requisite skills or resources to perform pre-construction works given that these activities are normally carried out by a TO. It may not be important whether it is NETSO or the onshore TO, so long as the correct

business separation arrangements are in place between NGET and any OFTO bidder affiliate.

***The process for proposals for this type of work to be put forward by third parties, including any need for consultation/publication to ensure interested parties are adequately engaged in the process.***

It is not clear in this question as to whom “third parties” refers. We assume here that it is anyone except the offshore wind farm developer (the generator). The most likely third parties to put forward proposals for pre-construction works are: NETSO; the onshore TOs; consultants; and potential OFTOs.

In our view if business separation arrangements are as strong as they should be, there will only be one or two entities that will want to both put themselves forward as an OFTO bidder and also as a third party developer. Assuming that business separation arrangements are sufficiently strong, we are likely not to seek to put ourselves forward as a third party developer given the constraints that would impose on us through the subsequent OFTO tender process.

Whilst we are perhaps not directly affected, we do also have concerns over the designs being put forward by NETSO and whether they will both meet the requirements of generators and provide value for money for consumers.

***What outputs might be required from a third party’s pre-construction activities on this type of asset, such as necessary surveys, wayleaves, consents and a tender specification.***

Required output will essentially be the same as they would be under an OFTO-build process where the generator had carried out the pre-construction works. This might include:

- Ground and other engineering surveys
- Environmental surveys and EIA documentation
- Consent application(s)
- Land rights (wayleaves for O/H lines, easements for cables and land lease or purchase options for substation sites)

***What further obligations might be necessary to ensure a fair and competitive tender, such as:***

- ***Any requirement for business separation between the third party and a related organisation intending to participate in a competitive tender process.***
- ***The need for certain assets to be transferred across from the third party to the successful bidder.***

The third party developer would be in an advantageous position with respect to its knowledge and experience of the project that it has been developing. Several measures are necessary to reduce the risk that it abuses this position. We believe that these should include:

- i) An absolute prohibition on any third party developer retaining the project into the construction stage. This is to ensure that the third party developer does not have a perverse incentive to delay completion of pre-construction works reducing the time available for running an OFTO tender process.
- ii) Incentives on the third party developer to complete the pre-construction works in a timely fashion as the ability of the generator to reach Financial Investment Decision (FID) might depend on this.
- iii) All data from the development stage is made available to all OFTO bidders and is transferred to the winning bidder.
- iv) Either a prohibition on any affiliate of a third party developer from taking part in the OFTO tender process or strong business separation between the third party that is executing the development work and any OFTO-bidder affiliates of the third party. The European “third package” measures for ITOs (see Annex 1) illustrate the degree of separation seen as necessary between dominant/monopolistic transmission entities and affiliates that are active in competitive markets and can benefit from preferential treatment.
- v) To ensure that the development is being undertaken in a manner that will make it suitable for adoption by an OFTO (e.g. risks properly managed, easements not unbankable, licences do not make unachievable promises, design doesn't lock-in use of a particular manufacturer). Ofgem should monitor the quality of the development work as well as adherence to milestones, and should have the power to replace the third-party developer if their performance is inadequate. Ofgem should also monitor to detect any abusive behaviour and suitable penalties. Given the difficulty inherent in detecting malpractice, penalties must be set at a high level to achieve deterrence. We suggest that abusive behaviour should result in the blacklisting of the abusers OFTO affiliate and any onshore competitive transmission affiliate from bidding for at least 5 years.

We support proposals for increasing third party involvement in onshore transmission developments and we recognise that there will be similar business separation issues between the onshore TOs who we would assume would be responsible for developing the onshore works put out to tender, and any bidder affiliate in an onshore transmission owner (ONTO) tender process. Therefore consistency in business separation requirements (or prohibitions) would seem sensible.

We are happy for this response to be made publicly available and to discuss any part of this response at your request.

Yours sincerely



**Chris Veal**  
Managing Director

## Annex 1 – Comparison of NGET and EU business separation arrangements

The table below compares the management separation provisions for NGET and National Grid Offshore with the management separation provisions set out in the third package (directive 2009/72) for Independent Transmission Owners. The directive deals with an analogous situation where it is necessary to ensure that a TSO with a monopoly role cannot abuse the position given by this monopoly in order to provide an advantage to competitive businesses that are part of the same group of companies (“vertically integrated undertaking”). As can be seen the directive provides safeguards that are both stronger and much more clearly defined than NGET’s compliance statement.

	<b>NGET C2 Compliance Statement</b>	<b>Directive 2009/72 ITO model (Articles 17 -22)</b>
General	“Maintain appropriate managerial and operational independence”. No definition of what level of separation is “appropriate” – self certified by an NGET director	“The [monopoly] transmission system operator shall have ... effective decision-making rights, independent from the vertically integrated undertaking” (Art 18,1)
Data processing and storage	“policies in place to ensure that no access [to NGET data] is granted to employees of [NG Offshore]”. Implies that same systems used, with separation through password access policies, etc.	The transmission system operator shall not share IT systems or equipment ... with any part of the vertically integrated undertaking nor use the same consultants or external contractors for IT systems or equipment. (Art 17,5)
Management separation	Both NGET and NG Offshore report to Executive Director, UK (one level below Group CEO).	Supervisory body with independent, regulator-approved members ensures management separation of monopoly-TSO (Art 20). This supervisory body is responsible for personnel appointments within the monopoly-TSO (Art 19, 1), not the parent company.
Compliance Officer	Compliance officer is NGET staff member, reporting to the UK General Counsel (part of the legal department, a shared service used by NGET and National Grid Offshore).	Compliance officer is appointed by supervisory body (which has independent outside members). Appointment must be approved by regulatory authority.(Art 21)
Services provided by NGET to NG	Arms lengths basis, as defined and monitored by	Any agreements to provide services must be approved by

Offshore	shared-services compliance officer.	the national regulatory authority, Art 17(c)(ii) and Art 18,7
Shared services (includes Regulation department, Insurance, Legal)	“Individual employees and agents of NG shared services will not concurrently serve both NGET and [NG Offshore]”	Shared service organisations within the group are not allowed – monopoly TSO cannot receive services from other parts of vertically integrated undertaking (Art 17,1(c)).
Transfer of employees	“ NGET will manage the transfer of employees [to avoid information leaking]”. Each case considered by the (shared-service legal department) compliance officer. “A transitional time period appropriate to the circumstances will be agreed by the [compliance officer] on a case by case basis.” No guidance given as to what may be appropriate – whole responsibility is given to the compliance officer.	6 month - 3 year gap before senior staff can transfer to monopoly-TSO arm (Art 19).  4 year gap before senior staff from monopoly-TSO can transfer to competitive activities. (Art 19, 7)
Auditing	No restrictions	The accounts of transmission system operators shall be audited by an auditor other than the one auditing the vertically integrated undertaking or any part thereof.
Staff remuneration	No restrictions	Remuneration, bonus, shares, etc, of monopoly-TSO staff must not be linked to success of other (competitive) activities. (Art 19,5)