

Offshore Transmission Cost Assessment Workshop

Development proposals

**Roger Morgan, Senior Manager,
Developer Engagement**

13 December 2013

ofgem

Points to note for today's workshop

- The issues we intend to cover during today are to facilitate debate and promote industry feedback
- If we are to make changes please note that there may be a need for consequential changes to the regulatory/industry framework
 - if raised we'll note such changes – but don't intend to dwell on these today

Progress to date

- Two workshops (Jan & July 2013)
- Bi-lateral meetings with developers
- Consultation document published 4 Dec 2013:
 - Builds on industry feedback
 - 3 key themes: offshore benchmarking, engagement with developers and incentives

Purpose of today's workshop

- Discuss consultation issues in detail
 - Ofgem to provide an overview of our consultation document
 - E.ON to provide a developer's perspective
- Provide clarity on consultation themes
 - inform your responses to our consultation document
 - closing date 11 February 2014

Today's Agenda

- 10.10 -11.00: Overview of consultation issues / E.ON presentation
- 11.00 – 11.15: Break
- 11.15 – 12.15: Roundtable discussions
- 12.15 – 12.30: Feedback session
- 12.30 – 12.45: Ofgem/developer information exchange
- 12.45 – 13.00: Summary of day, next steps

Summary of consultation issues

Fiona Alexander
Manager, Developer Engagement

What is Benchmarking?

- Process to compare one party's costs to others / to compare costs across industry.
- To establish what can be expected by an 'average' or 'best' performer in a comparator group.
- To help judge whether costs are efficient or a party is an outlier.

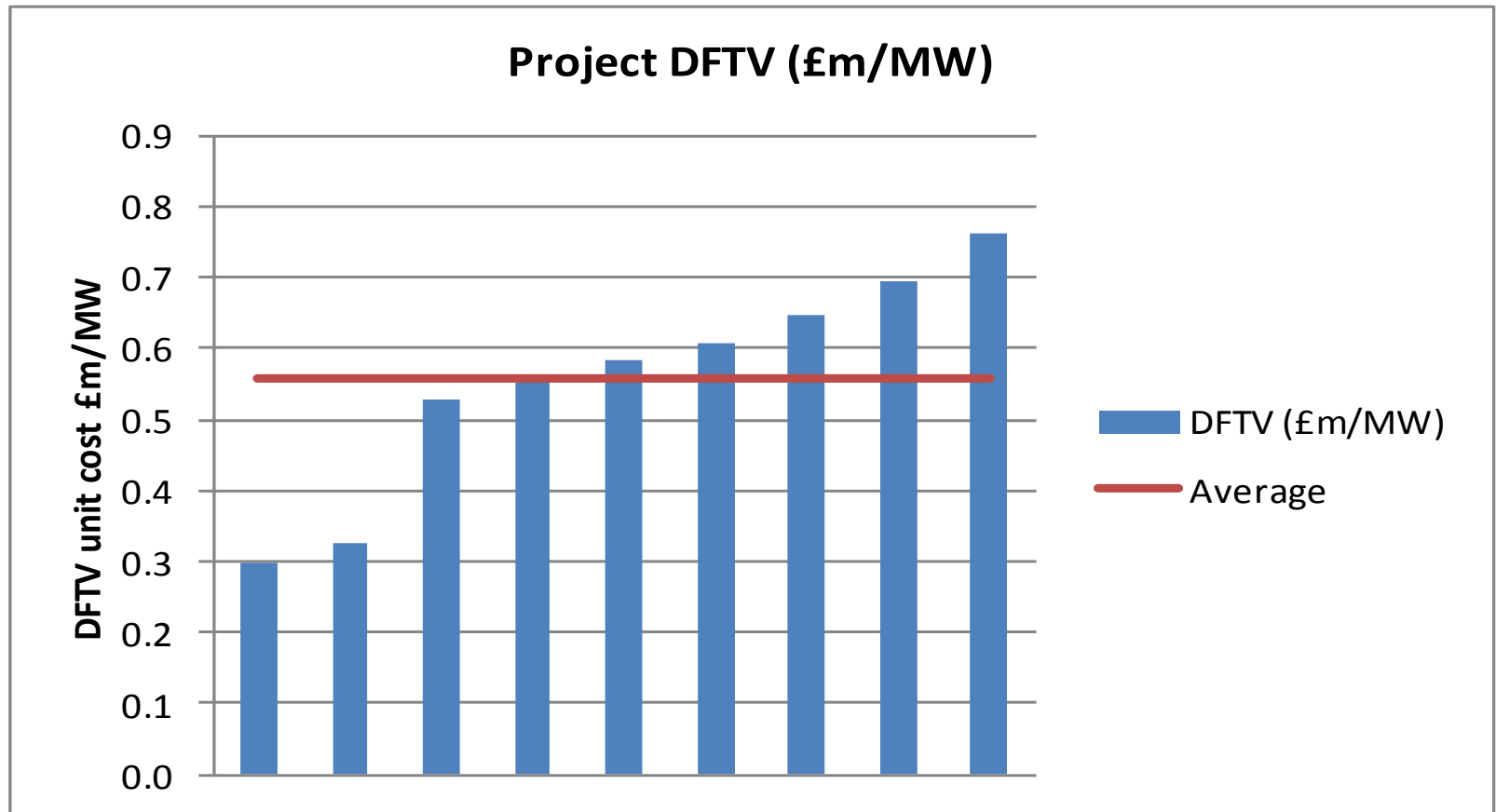
Benchmarking in offshore cost assessments

- Given the limited amount of comparable data – benchmarking has not been used to establish economic and efficient costs.
- We have used benchmarking to:
 - identify project cost outliers
 - cap IDC rates
 - cap development costs

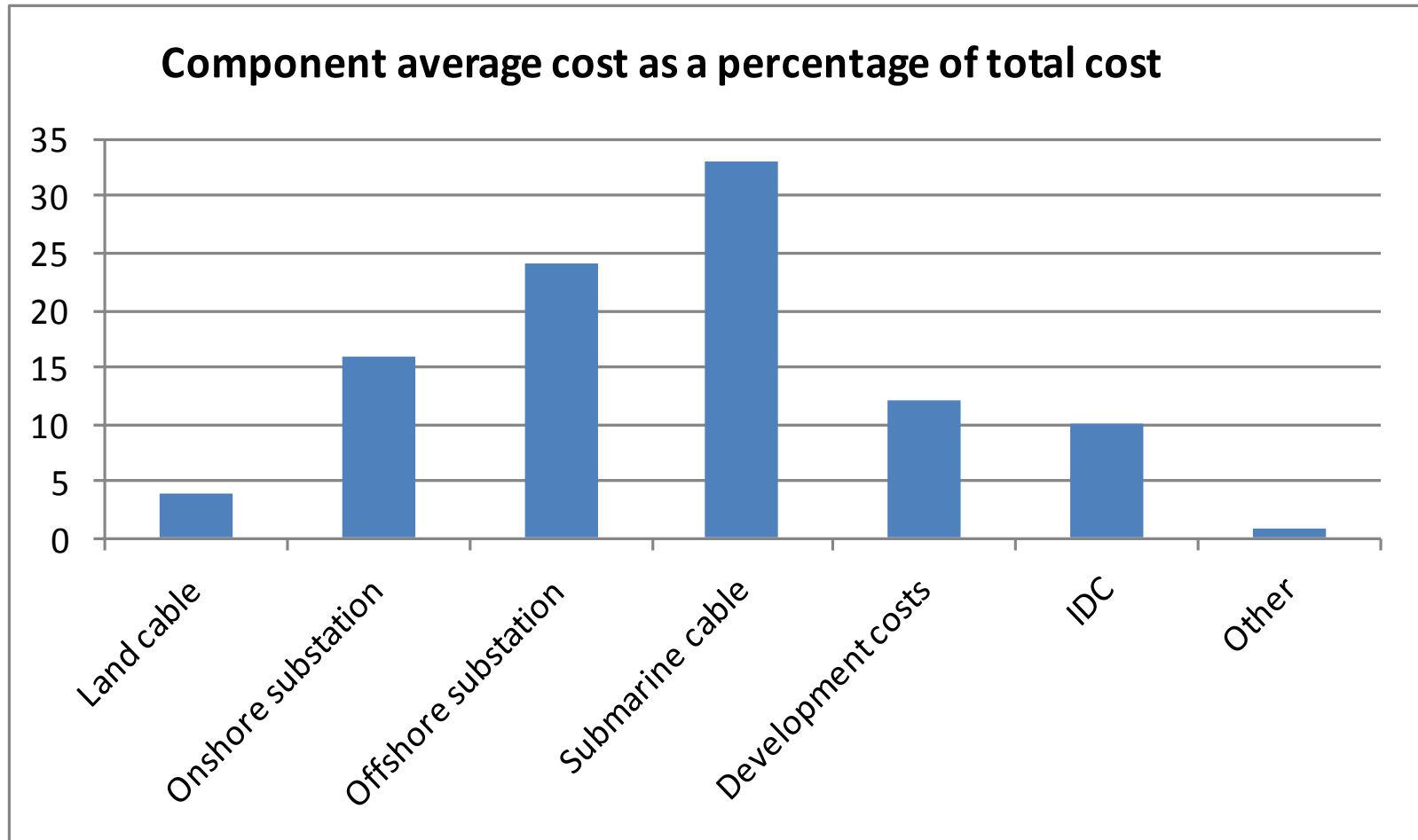
Potential options for developing benchmarking

- What is the most relevant data set for benchmarking purposes?
 - Our initial view: Developer final costs corrected for errors or Ofgem's FTV?
 - We have used DFTV in consultation for illustrative purposes
- Potential use of benchmarking to help establish the economic and efficient cost for future offshore transmission projects:
 - Total cost benchmarking OR component level

Total project cost benchmarking



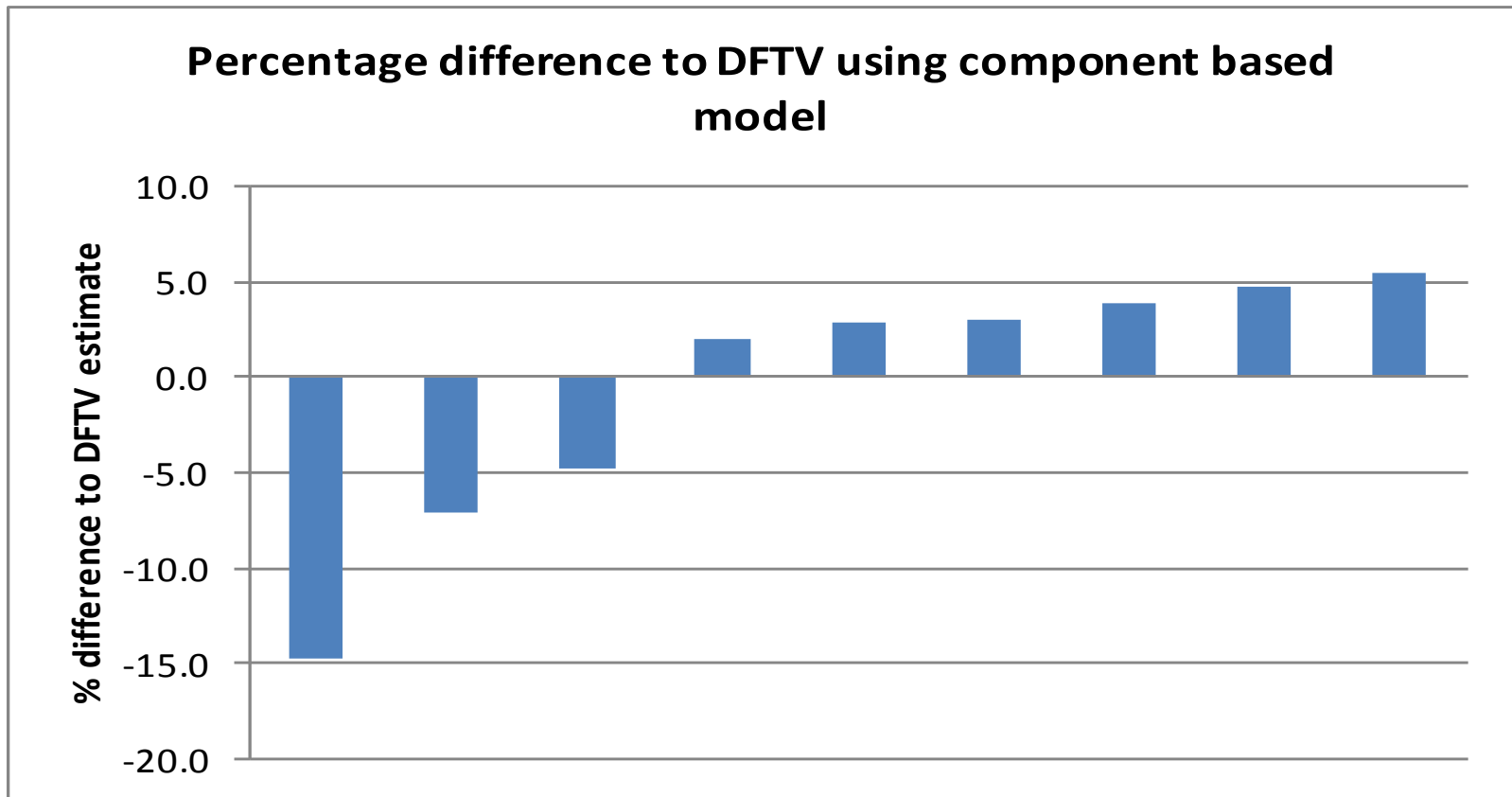
Component cost benchmarking



Current analysis for main components

Component	Cost drive unit (£m/driver unit)	Co-efficient	Goodness of fit (R ²)	Comments
Land cable supply and installation	km	1.214	0.744	For cable length less than 10km
Land cable supply and installation	km	0.555	n/a (too few points)	For cable length more than 10km
Onshore substation	MW	0.014	0.636	Excludes civils costs
Offshore substation	MW	0.013	0.824	Excludes platform costs
Submarine cable supply	km	0.489	0.941	132kV cables only
Submarine cable installation	km	0.352	0.578	
Development costs	Direct costs	0.155	0.888	
IDC	Total spend	Less than or equal to 8.5%	n/a (market based data)	Currently under review

Percentage difference to DFTV using component based model



Ofgem engagement - key project stages

- Connection offer
- High level design and consent
- Procurement
- Financial investment decision
- Construction

Engagement options

- Option 1: retain current process with minor clarifications
- Option 2: collect data and review accuracy/ completeness at each project stage
- Option 3: Collect data and assess costs at each project stage
- Option 4: Defer cost assessment until after preferred bidder has been appointed

Incentive mechanism – key considerations

- Target value with an assessment after the completion of the activity.
- Where cost deviate from the proposed target, there are a number of options for dealing with the difference:
 - Excess costs or savings from over/ under spend
 - Pre – agreed symmetrical/ asymmetrical mechanism – allowing for sharing gains and losses
 - Separate treatment of specific cost elements in response to changes in assumptions
- TNUoS charge interaction

Next steps

- Benchmarking peer review – lead to publication of data in first quarter of 2014
- We are happy to stage bi-lateral meetings with developers.
- Consultation closes 11 February 2014.
- We may set out proposals in Q2 2014.



Guy Phillips

Offshore Cost Assessment Consultation Workshop

Monday, 16 December 2013

Developers Perspective

- Previous experience through Robin Rigg East and West, the first to transfer, and London Array, the largest transfer to date.
- Generally the process works well
- Version control important
- Process can take too long between issuing new versions of the cost assessment.
- Changes in staff both at Ofgem and in the Developer teams can lead to the reason for changes to values in the cost template being lost.

Developers Perspective

- No apparent benefit to doing the cost assessment process in stages. Everything remains open until final transfer value confirmed. Better to at least indicate those areas that, subject to new issues on the plant, are actually closed out.
- Where Ofgem does choose to use consultants to justify costs, they need to be allowed sufficient time to do this.
- Factor in Ofgem approval process to timescales for setting the Initial and Indicative Transfer Values
- Ability to use appropriate estimates to close things out for the Final Transfer Value would be useful

Initial thoughts on Ofgem consultation

- Benchmarking
 - Additional information helpful, benchmarking methodology limitations
 - Unique designs
 - Timeframe
 - Different contract strategies
- Ofgem engagement
 - Improvements to option 1 reflect our feedback and experience
- Efficiency incentives
 - FTV feeds directly in to TNUoS charges
 - Not clear how an incentive mechanism would work and be in the interest of customers

Information Exchange in the Cost Assessment Process

Phill Heyden
Manager, Developer Engagement

Overview of slides

- Background and context
- Data issues
- Areas of improvement
- Data requirements / timing
- Templates
- Proposed next steps

Cost assessment process

Initial work commences



Ofgem supplies cost template, developer completes and sends submissions, we sense check data and set an **initial transfer value**

Indicative transfer value (ITV)



Developer updates cost submissions, we undertake ex-ante analysis, involving benchmarking analysis, a forensic accounting review, technical review - the resulting information is used to set an **indicative transfer value (ex-ante)**

Updates

Developers continue to provide periodic updated forecasts as we move towards finalising the cost assessment process

Final Transfer value (FTV)



The process to set the **final transfer value (ex-post)** commences once a project reaches 90-95% of project outturn costs – this involves a forensic review, benchmarking of each category with a technical assessment on material increases from the ITV

Analysis of information

- We apply two tests to the cost submissions provided by developers:

Test one – assessing the accuracy and allocation of developers cost submissions

Test two – assessing if developers costs are economic and efficient

Data issues

- Cost assessment data:
 - information supplied is not in a standard format
 - cost allocation methodologies not fully explained
 - incomplete / inaccurate information
- Forensic and technical reviews:
 - information not prepared / available when site visits are carried out
 - loss of expertise / people moving to other roles

Areas of improvement

- The cost assessment template (CAT)
 - consistency with NGET TNUoS requirements
 - version control
- project management costs
 - man hour rates, hours applicable to OFTO, description of tasks
 - split IDC cashflow - aligned to asset completion
 - developer data room
 - tracking cost increases / substantiation

Data requirements / Timing

- Key requirements:
 - summary of all of the costs including lower level cost movements by assets type
 - reconciliation/explanations for cost movements between different versions
- Timing of submissions (after the ITV?):
 - on quarterly basis / after presenting costs to project board?
 - when there are significant costs increases to an asset (say £Xm and/or +X%)?
 - any other?

Template - example 1

London Eye Offshore Windfarm Contracts overview V1.0							
Contract Overview	Projected Costs September 2014 - Initial transfer value £'s (A)	Projected Costs December 2014 - indicative transfer value £'s (B)	Variance (B-A) £'s	Projected Costs Q3 September - 2015 £'s (C)	Variance (C-B) £'s	Supplier (?)	Commentary
CR2 - Project common costs (Development cost, administration & management)	10.00	11.00	1.0	12.00	1.0		£1m increase due to extended project management time for important meetings with Ofgem
CR3 - Offshore Substation	20.00	18.00	-2.0	22.00	4.0		<ul style="list-style-type: none"> ◆£2m increase due to installation vessel unavailability (VO 2) ◆£2m increase due to construction delays

Template - example 2

London Eye Offshore Wind Farm onshore cable costs V1.0									
Contract Overview	Projected Costs September - 2009 £'s (A)	Projected Costs December - 2009 £'s (B)	Date	Variance (B - A) £'s	Projected Costs Q3 September - 2011 £'s (C)	Date	Variance (C - B) £'s	% Allocation to OFTO	Commentary on cost status and variance
Land cable									
A) Engineering hours to landcable	500,000	510,000		10,000	530,000		20,000	100%	£20k increase due to HDD being used
B) Onshore Cable Supply	2,000,000	2,100,000		100,000	2,300,000		200,000	100%	£200k increase due to copper prices increasing

Proposed next steps

- Establish industry working group to consider improvements related to:
 - templates
 - TNUoS requirements
 - project management costs
 - IDC
 - use of the data room
- Workshops to take place in early 2014
 - volunteers?

Ofgem is the Office of Gas and Electricity Markets.

Our priority is to protect and to make a positive difference for all energy consumers. We work to promote value for money, security of supply and sustainability for present and future generations. We do this through the supervision and development of markets, regulation and the delivery of government schemes.

We work effectively with, but independently of, government, the energy industry and other stakeholders. We do so within a legal framework determined by the UK government and the European Union.