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Dear Pete,

### **Offshore Transmission: Non Developer-Led Wider Network Benefit Investment**

National Grid Electricity Transmission (NGET) welcomes the opportunity to respond to the recent consultation on Offshore Transmission: Non Developer-Led Wider Network Benefit Investment. This response is on behalf of NGET and is not confidential.

The consultation seeks views on three potential models for co-ordinating non developer led wider network benefit investment (WNBI): Split OFTO Build, Early OFTO Build and TO Initiated Late OFTO Build. It considers whether these approaches could reduce the costs of asset development and thus the costs ultimately faced by consumers.

We welcome the fact that Ofgem are actively seeking out options that will protect the interests of existing and future consumers in relation to the development of the GB transmission network. We have a number of questions in relation to the models and do not believe that the case for these options being in the ultimate interests of consumers has been proven.

Our principal questions relate to the potential for these models to result in timing delays with associated costs, and the challenges of risk and incentive allocation that are inherent within any split-tendering model. These principal points are linked. In our view, benefits to consumers that exceed these challenges would need to be identified to make any of these approaches the right way forward: we explore this point further within our response. We then go on to address a number of further issues including consenting and way-leave issues, the transition of staff from preliminary works to Construction, the role of the Offshore TOs and the NETSO, the role of Ofgem in assessing WBNI and some further specific comments on each of the models.

We believe that there are big challenges to be addressed in making all of this work and ITPR is a key project, already underway, that is also trying to do this. It is important to minimise the potential for similar questions to be addressed in different Consultations and we would encourage Ofgem to look for ways to minimise the potential for confusion that multiple delivery vehicles could bring about (both in terms of development and implementation). If there are specific projects that Ofgem feels the need to have a decision taken on in advance of reaching ITPR conclusions, we would encourage further consideration as to the most expedient approach to allow these projects to progress in a timely manner.

We look forward to exploring all of the issues outlined in this response further with Ofgem and other interested parties.

## **1. Timing delays due to scoping issues**

Any tendering process and associated transfer of responsibility and accountability will, by its very nature, result in either a timing delay, or consumers being exposed to higher operating costs until the re-enforcement work is complete. Without further clarity as to how these potential disadvantages to consumers could be mitigated, all of the split-tendering models could be construed as containing the same inherent design flaw. On the face of it, the most effective way to mitigate these challenges to the consumer would be for one party to progress the project from beginning to end. Moving from this premise requires clear evidence that there are benefits to consumers that outweigh these disadvantages/ associated costs and it is not clear that sufficient evidence has been demonstrated in relation to our two principal points on timing delay and incentive/ risk allocation (where further detail is set out below).

## **2. Allocation of Risks, Liabilities and the appropriate Incentives**

As we have highlighted in previous consultation responses, risk is inherent at each of the separate stages of a project. We share Ofgem's view, expressed in paragraph 2.25, that "...risks should be best allocated to those best placed to manage them." However, it is not clear what this might look like in practice and, further, it is not obvious that a party that does not either own the relevant assets or have the future prospect of owning them could meaningfully cover risk in relation to a large project. Equally, whilst we note the sentiment in 2.26 that some risks should be shared with the consumer (such as external factors changing the need case for the investment), in practice, this could put consumers in a weaker position than they are today given current incentives to manage (rather than transfer) such risks.

Paragraph 2.29 makes reference to ensuring that the appropriate incentives and obligations are placed on the party leading the preliminary works. The very nature of the value imbalance in the scale of the work between the pre and post- construction phases makes this difficult to do. In particular, the limited value inherent in the pre-construction works themselves makes it difficult to establish a strong incentive for this phase of the process. It is not clear how the party undertaking the design and consenting process can be properly incentivised if they will not live with the long term consequences of the design. Keeping design and delivery together helps to ensure the developer will internalise the trade-offs between investment and operational costs, between more detailed (higher cost) sea bed surveys with reduced installation risk, and lower cost surveys which might lead to unexpected installation issues.

The undertaking of pre-construction works by a party different from the final constructing party will lead to the introduction of design risk through the addition of handovers (procurement, consent, etc) and the inherent inefficiencies that they can bring. These inefficiencies will ultimately lead to increased costs and or delays to consumers.

We believe further consideration needs to be given to the management of liabilities and design choices such that subsequent parties (who will be responsible for delivery and operational liabilities) do not re-work activities already completed by others thereby wasting time, resources and money and so adversely impacting the timely delivery of the project. We would welcome further detail from Ofgem on this crucial issue.

There are a number of other associated incentive based issues to consider. While the TOs may be obliged to undertake the pre-construction work, the question remains as to how to ensure that the work is completed to the appropriate standard and timescales. It is also unclear whether the TOs are resourced to undertake this activity and, if not, what the appropriate route would be for addressing this challenge. Equally, given the uncertainty of future generation developments, it is important to ensure that there is sufficient flexibility in funding to allow a full range of options to be identified and developed as appropriate. Furthermore, if the incentivisation is not correct at the pre-construction phase, this could lead to either a lack of options being developed, or schemes being insufficiently developed to support a robust risk register.

### **3. Consenting and Way-leave Issues**

The consenting process is a vital one that involves working closely with the public and a range of stakeholders. However, it can be contentious and it is not immediately clear that it will be sufficiently attractive to parties who are not going to go on and build the asset. That said, we do recognise that there are a range of business models and look forward to seeing the views of others on this point.

It is inherent in the nature of the consenting and way-leaves process that it creates legal conditions that need to be carried through to the subsequent construction phase. There is scope for this to become problematic in situations where a different party has secured the consents, from the party which is going to undertake the subsequent construction work. While in theory, the conditions tied in with any granted consent should be delivered by the party that builds the infrastructure, it is possible that the constructing party sees those conditions as limiting their ability to act economically and efficiently. In these circumstances, the building party may seek to alter the original consented conditions, creating potential programme delays and undermining trust in the party that originally secured the consent.

The issue of trust is an important one, as consenting is a major stakeholder process that has the potential to impact a company's long-term reputation. If a TO is obligated to consent for another party to construct and then this party does not fulfil the original consent requirements, it will undermine the reputation of the TO both locally and nationally, impacting its ability to take forward its licensed business. This 'cross regime' risk is another point we would like to explore further with Ofgem.

We would also note that the Consultation is predicated on the basis that all consents and land rights will be in place prior to moving to construction phase. Separating pre-construction from construction activities is problematic, but having a handover in mid-flight is even more challenging. Within a split-tender, regardless of the point at which the handover is completed, interactions between the high level and detailed design remain, along with the challenge of which party progresses which part of the consenting process. Our experience on the Western HVDC Link has demonstrated that it was ultimately in the consumers' interest to award the main construction contract before all consents were granted. This avoided undue project delays, allowed the construction party the freedom to innovate without being constrained by agreed consent conditions, and minimised consequential increases in operational costs. This, therefore, represented the best deal for GB consumers.

#### **4. Transition of staff from preliminary works to Construction**

We would note the possibility that if staff are dedicated to a particular project at the preliminary stage, it is possible that they could find themselves transferred with the project at the construction phase by the operation of employment law and this is a further area that requires careful thought.

#### **5. The Role of onshore TOs and the NETSO**

At a practical level, we would note that developing an appropriate need case is a resource intensive exercise. Currently, the associated costs are booked against the relevant asset, but this would be difficult to do under a split-developer model where a different party was ultimately taking forward the construction work. In such a scenario, further consideration would need to be given to the associated NETSO and TO funding arrangements. We would also welcome further clarity on the relevant incentives here. It is important that whichever party is taking forward this work is incentivised to pursue options vigorously and we would have a concern that, if the costs of undertaking these activities were regulated *ex-post*, this might not be the case.

We would also highlight that creating the tender specification establishes the framework under which the project is taken forward, including who takes the associated risks. This can significantly impact on the delivery and cost of the project. In our view, this specification should be undertaken by the party doing the work with the NETSO role restricted to producing a high level functional specification.

In terms of the broader issue raised of the NETSO being given an enhanced role in co-ordination, we would agree that this has merits but would also note the interactions with work underway as part of the ITPR project. As highlighted at the outset of this response, we believe it would be sensible to let the broader ITPR work run its course, rather than focus on the specific questions raised by Non-Developer-Led Wider Network Benefit Investment in isolation. As this will avoid either prejudicing the ITPR work or inconsistencies of approach developing in the future.

#### **6. The Role of Ofgem in assessing WNBI and the relative attractiveness of pre- and actual construction options for potential developers**

We would welcome Ofgem firming up the criteria for assessment in order to determine who is best placed to develop projects. This will go some way to determining the attractiveness (or otherwise) of the pre and actual construction options for developers. Whilst it is not for National Grid to speculate as to the commercial choices other parties might make, it is not immediately obvious to us as to why any party would submit a pre-construction request for WNBI if they were simply undertaking pre-construction work for other parties. It might make more sense for such parties to simply wait and then bid to undertake the actual construction stage. Albeit, we fully recognise this is not “one size fits all,” and it is perfectly possible that there are a range of business models available: Ofgem criteria in this area would certainly help to fully frame this debate.

On a separate point, we would note that in Paragraph 2.20, Ofgem states that it expects developers of offshore generation to engage and share information so as to facilitate identifying the preferred solution, supporting the needs case and so on. However, it is likely that at this stage of development the parties concerned will not have any form of transmission (or generation) licence to define the required behaviour. Ofgem’s ability to

require and enforce the appropriate behaviour would therefore appear to be limited and parties may also feel constrained by the requirements of competition law, inhibiting their willingness to collaborate. This might be another area where Ofgem gives further consideration to its role and the best ways of delivering the desired outcomes.

## **7. Specific observations on the models outlined**

We would welcome further detail on all of the models that have been outlined in the Consultation document as many of our questions are predicated on the need to understand in more depth how the various models might work in practice. Whilst most of the generic questions above are pertinent across all the models, we would offer the following model specific observations.

**Split OFTO Build** – It is not immediately clear as to what the first licensee who was undertaking the preliminary works would be licensed to do. In doing these preliminary works, the party would not be engaging in any of the current licensable activities and it is not clear what would actually be licensed, particularly as the preliminary franchise will not turn into any transmission activity unless the same party wins the second tender. Even if licensed, it is not clear how this work would be incentivised, particularly given the possibility of an *ex-post* downward assessment of allowed expenditure being applied.

**Early OFTO Build** – It is not entirely obvious what the NETSO role would be under this model and this is something that needs further exploration. We would envisage that the NETSO would need to be involved in establishing the need case as it is questionable that the TO would have sufficient knowledge to do this. One of the key questions here is the counterfactual of what would happen if the coordinated works were not built: this would presumably turn on an assessment of the NETSO costs that would otherwise arise and this appears to be a “core” function of the NETSO.

**TO initiated late OFTO Build** – We would welcome further detail as to the precise proposed roles of the TOs and other parties under this model. The “To initiated late OFTO Build,” and the “Early OFTO Build model,” both raise questions around roles, responsibilities and the associated management of potential conflicts of interest. These questions have been touched on in DECC’s work on business separation rules for the introduction of EMR and, more generally, need to be considered under the broader umbrella of ITPR, to ensure clarity and consistency. For us, this is another area where linkage with ITPR and other workstreams is crucial.

## **Conclusion**

We welcome the opportunity to respond to this Consultation and share Ofgem’s commitment to looking at options that could prove to be in the best interests of consumers. However, this is an area where many questions remain unanswered and it is not clear to us that any of the split-tendering models that are outlined meet this test. In particular, issues around potential delays and the inherent difficulties of allocating liabilities and incentives require more detailed work. We would also like to highlight again the interaction between this work and that underway via the ITPR route and to suggest that there could be sense in combining the questions raised here within that process.



We are happy to discuss our views contained within this letter further should that be helpful. For further details, please contact Ben Graff [ben.graff@nationalgrid.com](mailto:ben.graff@nationalgrid.com)

Yours sincerely

*[By email]*

Phil Sheppard  
Head of Network Strategy

## **Appendix 1: Questions raised within the Offshore Transmission: Non Developer-Led Wider Network Benefit Investment**

- 1. Do you consider there would be market interest in tenders under these non developer-led WNBI models? Please state why or why not, including whether you would be an interested party.**

The critical issues with non-developer-led WNBI models as highlighted above, relate to the level of risk the parties will take on and the associated liabilities. As we have previously noted, this must be carefully thought through with clear accountability at the various stages of the design, procurement, build and maintainance processes. The key question is where the liability sits for issues arising in construction that were not evident at the design stage. This will have an impact on risk and therefore the cost of capital. It is not for us to speculate as to whether there would be market interest in tenders under these non-developer led models, but as we note above, it is not immediately obvious why parties would bid for the pre-construction work when they could wait and subsequently bid for the far greater value actual Construction work.

- 2. What are your views on the role that onshore TOs and the NETSO would need to undertake to ensure success of non developer-led WNBI projects under the different models?**

We have highlighted in the letter above some specific views around the role of onshore TOs and the NETSO in this environment (in particular around the questions of tender specification, resourcing requirements and incentivisation under models where there is no asset to link the incentive to).

We would need to see more detail in order to comment in much more detail, but would note at this stage that Models 1 and 2 (Split OFTO Build and Early OFTO Build) are predicated on the Transmission Owner outlining possible options for the System Operator to then select preferred options and as such, in this regard, are similar to the anticipated direction of travel under ITPR. The third model (TO Initiated

Late OFTO Build) raises particular concerns over issues relating to risks and liabilities (for example in relation to consents and procurement). This is an area where we have requested further clarity in previous consultation responses and it is still not clear how these issues will be dealt with.

We would also re-iterate our previous point about the linkage between some of the questions posed in this Consultation document and ITPR and the need to ensure consistent and joined up outcomes.

**3. What are your views on the appropriate risk allocation between consumers and parties undertaking preliminary or construction works, and why?**

It is vital that the right risk allocation exists between consumers and the elements of the supply chain. Risks need to be placed with those who are best able to manage them. Whilst in this instance, this would not appear to be consumers, models that split responsibilities are likely to default to a situation where the consumer takes on more risk. As we note above, there are instances where risks that National Grid are currently incentivised to manage end up being “backed off” onto consumers going forward. We would question whether this is really in consumers interests. It may be noted that where, for example, a tendering party is taking risk in relation to pre-construction, there is no opportunity to have a clear route to hedging that risk against the prospect of owning (and receiving a revenue stream in respect of) the relevant assets. Not only does this imply that it may be difficult to develop appropriate incentives to encourage interest in, and sufficient discharge of this activity, it also implies that the risks may be more likely to be passed back to consumers.

**4. What are your views on the incentives and obligations that would be needed to ensure that the preliminary works, including consents, are completed in the interests of consumers and the economic and efficient development of the future transmission system?**

We would envisage that all licensees are bound by obligations to act economically and efficiently. The question becomes on what basis do you set incentives and how do you measure the counterfactuals? It is possible to envisage a scenario in which designs and surveys are undertaken in accordance with industry best practice but still reveal problems in Construction. This all comes back to issues surrounding liabilities and risk allocation and these are questions which require further clarity. However, as stated above, it is not clear how this would work in practice when it is not obvious that such a party is carrying out any licensable activity, against which a licence may be granted and used to deliver the relevant incentive.

**5. To what extent do you think the alternative models would help deliver the objectives set out in paragraph 2.32 of Chapter 2?**

It is not clear that the existing OFTO model adequately delivers the best outcome for consumers. Risk allocation and the timings of tenders both have the potential to delay infrastructure delivery and stifle innovation. This should be considered under ITPR as part of the Contestability work – recognising that the default OFTO regime may not be the best way to deliver all OFTO infrastructure. Hence, whilst we welcome Ofgem looking at this area, we do not think it has been sufficiently demonstrated that these models are actually in the interests of consumers.