

Inveralmond House  
200 Dunkeld Road  
Perth  
PH1 3AQ  
[malcolm.burns@sse.com](mailto:malcolm.burns@sse.com)

Pete Wightman  
Ofgem  
9 Millbank  
London  
SW1P 3GE

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Dear Pete,

**Offshore Transmission: Non Developer-Led Wider Network Benefit Investment (WNBI)**

SHE Transmission is pleased to respond and comment on the offshore transmission consultation referenced above.

The consultation itself acknowledges the interaction with Ofgem's Integrated Transmission Planning and Regulation (ITPR) project and in 3.4 on page 21 flags that, "*the models presented in this consultation could feed into ITPR policy development*". We note the specific parameters of this consultation and respond within them but maintain our position from August 2013 in response to Ofgem's ITPR "Emerging Thinking" that adoption of a single category of GB transmission licence would address and simplify many of the issues seeking to be managed.

Our specific responses to questions 2.1 to 2.5 posed in the offshore WNBI consultation are contained in Appendix 1 of this response and are summarised below. We have attached related notes from July 2013 concerning potential arrangements for a single category of transmission owner as Appendix 2

***Effective competition***

Competition in respect of offshore WNBI is likely to be more effective the greater the number of experienced, competent bidders that are eligible to take part. SHE Transmission has the skills and experience to participate and we do not believe that there is any European or primary UK legislation that prevents the geographic area in which SHE Transmission could own transmission being extended to include GB offshore.

***Views on Transmission Owner (TO) role under the three Models***

- Complexity, inefficiencies and questions over incentivisation and commitment of a 3<sup>rd</sup> party would compromise the effectiveness of **Model 1** (*Split OFTO model*).
- We strongly oppose **Model 3** (*TO Initiated Late OFTO*). Bidders could legitimately argue that a TO's knowledge of the scheme, and its influence over consenting and tender drafting choices should preclude the TO from bidding to build and own the asset. Exclusion of the TOs from

the bidding would have the negative effect of reducing competition. The obligation to commit resources to pre-construction activities without the opportunity to own the assets is also unattractive for SHE Transmission.

- **Model 2** (*Early OFTO build*) of the three models on offer would be our preference, but with TO participation (and that of other affected TOs) limited to assessment of the impact on their own network of different offshore WNBI alternatives, and with tender drafting confirmed as the responsibility of the successful bidder.

### ***Risk allocation***

We agree that those undertaking pre-construction works in response to an agreed need identified by the NETSO and relevant TOs should not be exposed to changes in the need arising from factors outwith their control.

### ***Incentivisation of parties undertaking pre-construction works***

We question whether arrangements to incentivise a party undertaking pre-construction works without responsibility for delivery and ownership, could be practicable, and whether the inevitable complexity could be justified.

### ***The extent to which the models deliver the objectives of 2.32.***

We consider that a refinement of Model 2 as described above best minimises the negative impact of issues arising from splitting pre-construction from delivery and ownership. It also the most consistent with facilitating the participation of existing onshore TOs to, “*attract new entrants and sources of finance to the sector*”.

Please feel free to contact me if you require further clarification of any aspects of this response.

Yours sincerely,

Malcolm J. Burns

**Senior Regulation Manager**

## Appendix 1

### Consultation questions and SHE Transmission responses

#### 2.1 ***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.***

Competition in respect of offshore WNBI is likely to be more effective the greater the number of experienced, competent bidders that can take part. Indeed, one of the objectives of a model for offshore WNBI noted in 2.32 is to attract new entrants.

SHE Transmission has the skills and experience to participate, but as an existing GB onshore transmission licensee is ineligible under current UK arrangements. We do not believe that there is any European or primary UK legislation that prevents the geographic area in which SHE Transmission could own transmission being extended to include GB offshore thereby enabling SHE Transmission to take part.

Different funding arrangements applicable to offshore assets (twenty year fixed revenues) and to RIIO could be accommodated with separate “pots” under the SHE Transmission licence. However, as stated in our previous responses to ITPR consultations, SHE transmission advocates a single category of UK transmission licence as a means of facilitating greater integration of transmission networks. We re-attach here as Appendix 2, a single page of notes on potential arrangements applicable to a single category of transmission owner licence regime. This note was first provided to Ofgem on 26 July 2013 in the context of the live ITPR consultation at the time.

#### 2.2 ***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?***

##### *Summary*

The consultation invites comment on three alternative models for offshore WNBI (Figure 2, page 12). Staying within that scope, SHE Transmission’s summary conclusions are as follows:

- Complexity, inefficiencies and questions over incentivisation and commitment of a 3<sup>rd</sup> party would compromise the effectiveness of **Model 1** (*Split OFTO model*).
- We strongly oppose **Model 3** (*TO Initiated Late OFTO*). It is a poor fit with SHE Transmission’s business model where pre-construction activity with scarce specialist resource is undertaken with a view to asset ownership and not just for a margin on the costs. More importantly for GB customers however is the potential for other bidders to legitimately argue that the TO’s knowledge of the scheme, and its influence over consenting and tender drafting choices should preclude the TO from bidding to build and own. Exclusion of the TOs from the bidding would have the negative effect of reducing competition.

- **Model 2** (Early OFTO build) suffers less from the issues above but in our view, the participation of onshore TOs (and other affected TOs) should be limited to assessment of the impact on their own networks of alternative offshore WNBI reinforcements. Responsibility for tender specification and drafting should also sit with the successful bidder.

### *Discussion*

Our consideration of issues below provides the basis for our conclusion that from the three models proposed in the consultation, our preference would be for Model 2 with defined and limited TO participation that does not include tender drafting. There are a number of issues that we consider are particularly relevant to our consideration, the first two are closely related:

- Different parties for development and delivery; and
- Incentivisation of parties undertaking pre-construction activities.

These are discussed further below, both being particularly relevant to Model 1 and, in some cases Model 3.

### *Different parties for pre-construction and delivery*

This refers to separation of pre-construction consenting and tendering activities from the responsibility for asset delivery and ownership. The issue is most relevant in Models 1 and 3. The concern is that because the party undertaking the pre-construction activities knows that it will not be responsible for delivery it may have a lower threshold for risks outside of its control when agreeing to planning conditions, and may also miss other potential technical risks to delivery.

The point is that bidders are likely to price in a premium to their bids to cover the risk of accepting routing, consents, and even tender specifications undertaken by another party. This would represent an otherwise avoidable premium being included in the ultimate cost of the assets.

In our view, a better application of third party expert resource would be to scrutinise and challenge the justification for adjustments to the Tender Revenue Stream after pre-construction that would occur under Model 2 (paragraph 2.13 of the consultation).

### *Incentivisation of parties undertaking pre-construction activities*

Closely related to the above, is whether there are practical means to incentivise a party making key decisions relating to asset deliverability and lifetime availability when that party will not be responsible for delivery or ownership. No doubt there are conceivable arrangements that could expose pre-construction parties (third parties or TOs) to successful delivery and lifetime performance but would they be practical, and would the complexity be justified?

In the case of SHE Transmission, under current arrangements the responsibility for pre-construction and tendering is necessary and appropriate for the management of delivery risks and lifetime asset management. The RIIO arrangements and SHE Transmission's business model are based on

managing asset delivery and ownership risks for a return on assets. Under Model 3, an obligation to divert scarce specialist TO resource to pre-construction activity in respect of assets that the TO would have no opportunity to own would be unwelcome and potentially compromise obligations in respect of other projects.

#### *Other relevant issues*

##### *Effective competition*

Our response to 2.1 above notes that the greater the number of eligible, competent, credible bidders for offshore WNBI the more effective competition is likely to be. We also note in our response to 2.1 (above) that there are no legislative barriers to Ofgem exercising its powers to include offshore in the geographic area where SHE transmission could own transmission assets.

The point here is that under Model 3, if SHE Transmission were eligible to bid, other bidders could legitimately argue for a TO that had been directly involved in design and routing decisions as well as tender drafting, to be excluded from the bidding. The negative impact would be to reduce the number of bidders and lessen the effectiveness of the competition.

In our view, Model 3 is therefore not consistent with the objectives stated in paragraph 2.32 of the consultation to, “*attract new entrants and sources of finance to the sector*”.

##### *Model 2 refinement*

Of the three models described in the consultation our preference would be for a refinement of Model 2. This Model has least exposure of the three to the issues explored above but would benefit from some specific refinements.

In order to minimise the risk of the TO being rendered ineligible to bid on account of privileged knowledge, the role of the TO under Model 2 should be limited to assessing the impact on its network of alternative options for offshore WNBI identified by the NETSO. The same would apply to any other affected TO.

This would be consistent with current practice in the Connections and Infrastructure Options Note (CION) process for offshore windfarm connections. In that process, the TO inputs assessments of the impact and deliverability of works on its system of different options for offshore works. However, it is the OFTO designate (the Offshore Transmission System Development User Works developer, the “self-builder”) which sponsors the ultimate solution for connection of the windfarm and which is responsible for justifying it as the most economic option overall.

For the avoidance of doubt, under Model 2 equipment tender specifications should be the responsibility of the successful bidder for offshore WNBI.

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

We agree with the position in paragraph 2.25 of the consultation that risk should be allocated to those best placed to manage them. So for example, expenditure by TOs against allowances for pre-construction costs should continue to be subject to testing, as now, for activities having been being undertaken efficiently.

We also agree that those undertaking pre-construction works in response to an agreed need identified by SO and relevant TOs should not be exposed to changes in the need arising from factors outwith their control.

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

Please refer to our response under 2.2. where we question whether arrangements to incentivise a party undertaking pre-construction works without responsibility for delivery and ownership, could be practicable, and whether the inevitable complexity could be justified. We are not aware of any material benefits for competition or efficiency of separating pre-construction from delivery and ownership that would outweigh complex incentive arrangements for the pre-construction party.

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

We consider that a refinement of Model 2 as described above best minimises the negative impact of issues arising from splitting pre-construction from delivery and ownership. It also the most consistent with facilitating the participation of existing onshore TOs to, “attract new entrants and sources of finance to the sector”.

# **Integrated Transmission Planning and Regulation (ITPR)**

Notes by SHE Transmission on a single category of transmission owner licence regime

## **Context**

- Transmission assets, their delivery, maintenance and technology challenges are broadly common in nature across those that connect generation and load centres, transport bulk energy and so enable energy markets.
- High anticipated levels of capital requirements associated with UK and pan-European grid development.
- Clarity and stability of the investment proposition both for transmission asset investors and for those seeking to use the system is fundamental to accessing and attracting the necessary capital.

## **Description**

### *Single category of transmission licence ownership*

- A single category of transmission owner licence:
- No differentiation on the basis of geographic location (Scotland/England), wet or dry (onshore/offshore), or on function (generation connection/MITS/Interconnection): and
- Full flexibility for licence holders' to bid for the delivery and ownership of new transmission assets determined as suitable for competitive treatment.

### *Independent System Operator*

- Independent System Operator with holistic view across GB onshore and offshore transmission and European interfaces;
- No ownership of transmission assets by System Operator; and
- System Operator administers uniform access regime.

### *High level outline process*

- Independent GB System Operator function identifies broad system requirements, e.g. transfer capacity of at least "X"GW across Boundary "Y" by 20"ZZ";
- Defined criteria applied by Ofgem to identify projects suitable for competitive treatment; and
- All licensed TOs eligible but not obliged, to bid for delivery and ownership of reinforcement solutions. Flexibility to propose technology and sizing of choice with the justification for optimum sizing/future proofing included as a factor in the selection of a successful bid.

## **Implementation and timing**

- No change to the RII0-T1 settlement; and
- No re-allocation of existing assets or committed projects.