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Pete Wightman  
Ofgem  
107 West Regent Street  
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G2 2BA

3 March 2014

Dear Pete,

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

Thank you for giving us an opportunity to comment on the alternative approaches to developing and regulating this class of offshore transmission.

Transmission Investment is a leading offshore transmission company, with four Offshore Transmission Owners (OFTOs) under management and a fifth due shortly. We are also active in the development of new offshore infrastructure: we are developing the France-Alderney-Britain (FAB) interconnector project and we provide advisory services to other developers.

We would like to express our interest in tendering for the OFTO role under any of these options, and in the case of the Early OFTO Build model we wish to confirm that we have the necessary skills to undertake the development role that would be carried out by the OFTO under this option.

Our detailed comments are in the attached Annex.

Please let me know if you wish to discuss our response further; we would of course be delighted to explain our thinking in more detail.

Yours sincerely

A handwritten signature in blue ink that reads "Sean Kelly".

**Sean Kelly**  
Partner

## **ANNEX**

### **RESPONSES TO SPECIFIC QUESTIONS**

**Question 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.**

Three models are presented, each of which envisages a different type of entity undertaking “preliminary works” such as initial design engineering, cable routing, seabed survey, acquisition of property rights, environmental permitting and stakeholder liaison. Our view of the three models is as follows:

Split OFTO Build. This is based on a “third party” (i.e. not a transmission company) undertaking the preliminary works. Plausible candidates for the third party role include teams with experience from the development of offshore renewables and consortia of technical and environmental consultancies<sup>1</sup>.

If Ofgem selects this option then a suitable methodology for the remuneration of third parties will be required if the necessary level of interest from would-be third part developers is to be attracted. Whilst ensuring that any third party is properly incentivised, this methodology should limit the risks transferred to the third party – recognising the fact that such companies are likely to have a background in the advisory sector, where low-risk/low-capital business models are the norm. Given a suitable remuneration methodology, however, there should be strong interest from third parties – albeit that this may not become visible until actual non-generator WNBI projects emerge. We can confirm that Transmission Investment would be interested in building transmission assets developed by a third party developer.

Equipment manufacturers and installers would provide an alternative source of third parties, and would have the necessary technical ability. However such companies would only be interested in undertaking the preliminary works if by doing this they would secure the contract from the OFTO for the construction of the assets. There is no suggestion in the consultation paper that this would be allowed, and we believe that requiring OFTO bidders to use a particular manufacturer would not be in the interest of consumers and might be a violation of EU procurement rules.

Early OFTO Build. We believe that this option will attract strong market interest as companies whose ultimate desire is to own transmission assets will be willing to undertake the development of these assets in order to make this ownership possible. We can confirm that Transmission Investment would be interested in developing and building transmission assets on this basis.

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<sup>1</sup> On projects without an onshore connection (as shown in figure 1 in the consultation paper) environmental permitting is likely to be greatly simplified, reducing the complexity of any consortium.

TO-initiated Late OFTO Build. This approach is reasonable in principle and we note that it was previously Ofgem's lead option. However the feedback that Ofgem has received to date from onshore TOs has clearly been negative, with at least two out of three onshore TOs indicating that they did not wish to participate. This is likely to reflect a view among such companies that scarce resources – in particular staff skilled in offshore transmission, who are unlikely to be numerous in an onshore-focussed utility – are best devoted to the development and construction of assets that the company will ultimately own. However this option remains attractive in situations where a TO is willing to voluntarily undertake the development work, and we can confirm that Transmission Investment would be interested in building transmission assets developed by an onshore TO.

For both the Split OFTO Build and the TO-initiated OFTO Build options we have assumed that the party developing the project, and their affiliates, will not be permitted to compete to become the OFTO. Given that the roles of the developer will include *“populating the data room, responding to queries from bidders, and contributing to a smooth and timely tender process”*, there is a very clear conflict of interest if affiliates of the developer were to be allowed to bid.

**Question 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 WNBIs projects under the different models?**

We broadly agree with Ofgem's view of NETSO's role<sup>2</sup> (paragraphs 2.19 to 2.22). Basically we see NETSO's role as being:

- Identification of the need for new offshore infrastructure, and the high level specification of this infrastructure.
- Providing information needed by Ofgem when selecting an OFTO (Early OFTO Build model) or a third party developer (Split OFTO Build model). This may extend to writing the tender specification for Ofgem (as suggested in paragraph 2.21), but only if very strict business separation rules are in place and/or affiliates of NETSO are forbidden from tendering.
- Providing the party that is developing the project (whether OFTO, TO or third party) with the technical information they need to engineer their design.

With the Split OFTO Build and Early OFTO Build models the onshore TOs' role would be limited to providing an onshore connection for the project. On projects

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<sup>2</sup> At present NETSO's role in grid planning and design is still undertaken in conjunction with the TO(s) for the affected onshore areas. For offshore WNBIs projects, however, onshore impacts may be limited to a reduced need for onshore reinforcements, and so the role of the onshore TO would presumably be minimised. Transmission Investment supports proposals, as part of the ITPR project, to increase the NETSO's role in system planning.

without an onshore connection (as shown in figure 1 in the consultation paper) the onshore TOs are unlikely to have any role.

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

With all three options an OFTO is proposed to carry out the construction works. In our view the existing OFTO-build risk allocation should be retained for non-generator led WBNI projects, in particular:

- The OFTO should take all risk of capex and opex cost overrun where costs are within their control. Uncontrollable costs may be passed through, in the same way that the current OFTO regime passes through costs such as business rates and changes in decommissioning law.
- The OFTO's 20-year revenue stream should start when the asset is completed, to ensure that there is an incentive for timely commissioning of the asset.
- There should be an incentive on the OFTO to maintain a high level of asset availability. However it is possible that the level of penalties will be lower for WBNI assets than for traditional OFTO assets as in many cases a WBNI asset will not be critical for the operation of a wind farm, and will be just one of many redundant circuits that make up the grid infrastructure.
- The party undertaking development work should not be exposed to stranding risk as the development is being undertaken to NETSO specifications. Cancellation arrangements should be in place to cover situations where changes in generator background or preferred overall grid design mean that a project that is still under development needs to be abandoned. In view of the level of time and effort that developers are expected to contribute, these cancellation arrangements should not be limited to a refund of incurred costs.
- The OFTO should not be exposed to stranding risk while building the assets as it is building to a specification provided by NETSO, as part of its co-ordinated plan, and approved by Ofgem before the start of construction.

**Question 2.4: 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?**

An advantage of the Early OFTO Build model is that it inherently aligns the interests of the developer with those of the consumer. The consumer wants to see the project developed rapidly so that its benefits start to be realised, but doesn't want these benefits to be compromised by a design that is unnecessarily expensive, risky to build, unreliable, or difficult to maintain. As it combines the roles of developer, builder and ultimate owner, the OFTO sees the same mix of aims and is incentivised to trade-off appropriately between them

The Split OFTO Build and TO-initiated OFTO Build options are more problematic, since:

- Developers are likely to resist incentive arrangements that increase risks above the level that their businesses are used to (see response to 2.3 above).
- Even where incentives can be agreed with the developer, these are likely to be restricted to incentives for timely consenting and minimisation of development costs. Such incentives are unlikely to be balanced by rewards for producing high-quality deliverables<sup>3</sup>, due to the difficulty in quantifying the quality of deliverables and the difficulty in determining whether poor quality reflects poor performance by the developer or the impact of external forces
- It would not be possible for Ofgem to "police" the work undertaken by the developers as it would not be possible to prove that slow progress or the emergence of expensive, difficult-to-build designs were due to a lack of effort by the developer rather than being necessary compromises needed to obtain environmental approvals.

In the case of the TO-initiated model it may be necessary to force TOs, against their will, to develop projects (*"a potential variation of the model would be to oblige TOs to [develop non developer-led NBI projects] ... where non developer-led WNBIs projects are in the interests of an economic and efficient network"*). We do not believe that it is realistic to expect an unwilling party to develop a high quality project in a timely manner, and it is not feasible for Ofgem to punish poorly performing TOs since it is impossible to prove that the developer is to blame for slow progress and/or poor outcomes.

**Question 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?**

The table below shows our assessment of the options against the objectives set out by Ofgem:

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<sup>3</sup> High-quality deliverables would mean that the cable routing decisions, the land rights acquired for substations and cable corridors, and the environmental permits obtained, do not force OFTOs to build the assets in a manner that is unnecessarily expensive, risky, unreliable, etc.

<b>Objective</b>	<b>Split OFTO Build</b>	<b>Early OFTO build</b>	<b>TO Initiated Late OFTO Build</b>
<b>Delivery / quality</b>  (“deliver fit for purpose electricity transmission infrastructure to facilitate ...”)	Suitable third parties will come forward if commercial arrangements make the role sufficiently attractive.	Good incentives on OFTO	Most or all onshore TOs unwilling to participate – impractical to compel participation and to “police” quality of work
<b>Competition</b>  (“provide value to consumers by building on the existing offshore regulatory regime, retaining the benefits of competition ...”)	Competitive regime for developers.	Competitive regime for developers	No competition for development work; undertaken by incumbent monopoly
	Separate competitive regime for builder / owners	More difficult to compare build prices for competitive OFTO bidders	Separate competitive regime for builder / owners
<b>Co-ordination</b>  (“helping to capture the benefits of coordination”)	No difference – with all three models NETSO undertakes co-ordinated design and planning.		
<b>New Entrants</b>  (“attract new entrants ... to the sector”)	New entrants undertake development work	New entrants undertake development work (work not previously done by OFTOs)	Development work undertaken by incumbent monopolies
<b>New Sources of Finance</b>  (“attract new ... sources of finance to the sector”)	No difference – build is financed by OFTOs in all cases		
<b>Protect Consumers</b>  (“ensure that consumers are protected from undue stranding risk..”)	No difference –all options involve design by NETSO and assessment by Ofgem before construction starts.		