

Gordon Hutcheson
Transmission Competition Policy Team
Ofgem
9 Millbank
London
SW1P 3GE

DNV GL Energy Advisory
Networks, Markets & Strategy
5-11 Lavington Street
London
SE1 0NZ

Date: 29/9/2016
Our reference:
Your reference:

Extending Competition in Electricity Transmission: Tender Models and Market Offering

Dear Mr Hutcheson,

Please find below our response to the questions raised in your consultation on "Extending Competition in Electricity Transmission: Tender Models and Market Offering". Where we have a view we have expressed this and where we have no particular view we have omitted the question from our responses following.

DNV GL

Driven by its purpose of safeguarding life, property and the environment, DNV GL enables organizations to advance the safety and sustainability of their business. Our 15000 professionals in 100 countries provide classification and technical assurance along with independent expert advisory services to the energy, oil and gas and maritime industries.

In the energy industry - DNV GL delivers world-renowned testing and advisory services to the energy value chain. Our expertise spans onshore and offshore wind power, solar, conventional generation, transmission and distribution, smart grids, and sustainable energy use, as well as energy markets and regulations. Services to transmission asset investors include owners/lenders engineer as well other commercial, regulatory, assurance and risk based services.

In the oil and gas industry - DNV GL is the leading technical advisor to the global oil and gas industry.

For software - DNV GL is the world-leading provider of software for managing risk and improving asset performance in the energy, process and maritime industries.

For business assurance - DNV GL is one of the world's leading certification bodies. We help businesses assure the performance of their organizations, products, people, facilities and supply chains through certification, verification, assessment, and training services.

In the maritime industry - DNV GL is the world's leading classification society and a recognized advisor for the maritime industry.

Consultation Responses

CHAPTER: One

Question 1: How well aligned do you think the proposals in this document are with our objectives for onshore competition?

In our view the proposals set out align with your objectives for onshore competition.

Question 2: What do you think are the implications of our overall proposed policy around the tender process, CATO incentives and obligations on CATO cost of capital and levels of competition for a CATO licence?

We believe that Ofgem's expectation that a CATO licence would be granted in perpetuity and the assets owned by the CATO to remain the property of the CATO at the end of the revenue term is a positive step to ensuring the success of CATO for consumers. Also, the plan for full asset depreciation over the revenue term avoids the requirement and hence problems of accurately assessing asset condition, remaining life and value at the end of license period.

CHAPTER: Two

Question 1: What do you think about our proposed approach to tender evaluation? Are any elements missing that we ought to look at?

Our view is that the number of bidders that are permitted to go through to the ITT phase should be limited to 2, perhaps 3 bidders in some cases, due to the high costs of bidding. Any more may discourage prospective bidders particularly if they are not successful in the first ITTs.

Question 2: What are the main detailed aspects/criteria of our evaluation that you would like further clarity on as a priority over the next few months in order to inform your decision on whether or how to bid?

It is our view that at the EPQ phase, evidence of risk identification, understanding and management should also have a focus on construction risk and perhaps technology risk.

Also parts 7 and 8 of the proposed EPQ should be translated into a requirement for a mitigated project risk profile covering all phases and requiring a demonstration of how the mitigated risk profile would be maintained as the project progresses through all phases (preliminary work DD, FEED, construction, SO acceptance and operation, e.g. through audits or independent certification).

Question 3: What do you think about our proposals for variant bids? Which areas are likely to lead to the largest benefits for consumers?

Our experience in assessing SWW proposals suggests that variant bids could sometimes offer very significant savings to the consumer. The application of an independent assessment sometimes identifies benefits not previously stated. Therefore, Ofgem's acceptance of variant designs is highly likely, in the long run, to benefit consumers. So long as the opportunity of bringing forward substantive variants beneficial to the consumer is made clear to bidders from the start, then there would be a level playing field for them to propose variants that offer a better deal for system users or the environment.

However, if a variant showed genuine extra benefits over the compliant proposals, it would be important to:

- a) Protect the IP of the variant's bidder; and
- b) Avoid the benefit being dissipated through lengthy re-appraisals of the variant.

For these reasons, Ofgem's appraisal process would need to be fully prepared to accommodate the submission of a variant.

Our view is that some of the largest benefits could come through innovative routing options and technology selection.

Question 4: How could Ofgem best value the relative merits in variant bids of enhanced consumer outcomes, potential savings and likelihood of delivery where these do not align?

Based on DNV GL's experience of reviewing Strategic Wider Works we view it as important for consumer value for money that variants or alternative bids are received if the CATO asset/design options have not been thoroughly and robustly explored by the TO at the preliminary phase. More generally, it should be open to bidders to suggest solutions alternative to the original tender specification. The merits of such proposals can be explored with the SO and TO involved, and verified by an independent third party. The proposed outline option phase of the tender and the ITT phase would have to positively encourage this behaviour from bidders. Ofgem should consider awarding extra evaluation points for variant bids that offer genuine consumer and other stakeholder benefits.

Question 5: Do you consider that our proposed tender process stages and timings provide sufficient time for interaction with the supply chain and bidders to undertake required design work in order to put forward robust, fixed price bids at the ITT stage?

In our view the proposed timescales favour parties that already have suitable supply chains or facilities to set up new supply chain members.

CHAPTER: Three

Question 1: What do you think about our proposed package of CATO incentives? Do you think we are missing anything?

There is currently a lack of clarity as to who will certify that the built asset is fit for purpose and has met the CATO delivery obligations. This is particularly the case for the SO prior to asset delivery acceptance and start of the CATO revenue stream. In the OFTO regime DNV GL perceives that poor quality control provided by developers has resulted in a range of issues, particularly with transmission cable issues at handover or post hand over. Certification or verification against standards, codes and best practice guides could have improved this situation. The UK electricity industry seems to avoid formal independent verification or certification unless required by law, insurers or investors. Given the high values and long expected lives of CATO assets, as well as the increasing number of parties involved in building and maintaining the transmission network Ofgem should consider this area for improvements to protect stakeholders and consumers.

Question 2. What do you think about our proposals for the CATO availability incentive?

No further comment as DNV GL was involved in developing this incentive.

Question 4. What do you think about our proposed incentives for CATO asset management? Do you have any views on how we could best appraise asset health?

DNV GL notes that Ofgem's expected position at the end of the revenue period is to allow the CATO to continue to own, maintain and operate the asset. There will therefore be an incentive for the CATO to maintain the assets to achieve their expected operational life. We see this as a positive step in protecting consumer value.

Question 9: What do you think of the scope of proposed changes to industry codes and standards for CATOs that we set out in Appendix 4? What do you think would be the best mechanism for us to facilitate bidder market understanding of industry codes and standards (bearing in mind that Ofgem resourcing is limited and that there will always be a requirement for bidder due diligence)?

Industry workshops on codes and standards, augmented by bidder support from external advisors as required, would constitute a low cost approach for Ofgem.

CHAPTER: Four

Question 1: What do you think about our proposal to start CATO revenue on completion? Do you have any views on whether there would be benefit in allowing some revenue before completion for certain types of project, and if so, what should this be tied to?

See response to question 1 of Chapter 3.

Question 2: What do you think about our proposal to align the depreciation period with the CATO revenue term?

While this will increase annual costs to consumers over the initial 25-year revenue term, as modelled by Ofgem, over the lifetime of the asset this could reduce the overall cost to the consumer. The other main advantage is that it avoids the potential complexities over residual value and asset remaining life/condition at the end of the initial 25-year revenue period that could be a risk under whole asset life depreciation. However, it is DNV GL's view that full asset design life needs to be achieved for consumers to get full value for money. Full depreciation within the CATO revenue term could be seen as an opportunity for the CATO to justify asset replacement earlier than required from the technical perspective, thus reducing consumer value.

Question 3: Do you have any views on our proposals for arrangements at the end of the revenue term?

We agree with the approach to fully depreciate assets over the revenue period. We agree with the approach taken that the CATO would continue to own and operate the assets at the end of the initial revenue term under some form of price control, in line with Ofgem's

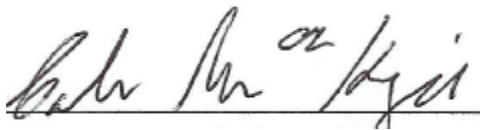
regulatory approach at the time. This may also incentivise the CATO to maintain assets for their expected asset design life and not to the end of the revenue period.

Question 6: What do you think about our proposed risk allocation for CATOs? How do you think we can best mitigate and/or allocate risks associated with preliminary works?

We consider that 3rd party assurance of the data room prior to the ITT could be an effective risk mitigating measure though, to be effective in reducing CATO risk and therefore consumer cost, the results of the assurance process, and decisions on any matters arising from the assurance exercise, would need to be made available as soon as possible and, in any event, early enough for bidders to take full account of them in their final bids.

Regarding Ofgem's procurement of these assurance services, for extreme cases of preliminary works inadequacy, part or all of the cost of the assurance could be passed on to the supplier of the preliminary works in the form of a performance fine.

Sincerely
for DNV GL Limited

A handwritten signature in dark ink, appearing to read 'Colin MacKenzie', written over a horizontal line.

Colin MacKenzie
Principal Consultant

Mobile: 07557741627
Colin.MacKenzie@dnvgl.com