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Reference: OFTO Tender Process consultation  
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Dear James,

### **Response to: OFTO Tender Process – Consultation For Future Tender Rounds**

innogy SE is a leading European energy company, with revenue of around €43 billion (2017), more than 42,000 employees and activities in 16 countries. With its three business segments Grid & Infrastructure, Retail and Renewables, innogy addresses the requirements of a modern, decarbonised, decentralised and digital energy world. In renewable power generation, the company has a total capacity of 3.9 gigawatts.

In the past 5 years, we have realised new renewable energy infrastructure in the UK worth £4 billion. UK is innogy's second largest operational market and the company currently operates more than 1GW of renewable energy in the UK with a development pipeline of around 3GW

We welcome the opportunity to respond to this consultation and thank Ofgem for holding their workshop on 30<sup>th</sup> April which was a great opportunity to discuss our response with Ofgem directly.

The OFTO regime is 9 years old in 2018, and it is anticipated that 5 tender rounds for OFTOs will be complete by the end of 2019. Innogy believes that the OFTO regime would benefit from a critical evaluation of its successes since its inception, and identification of areas where the regime as a whole could use lessons learned to build an even more robust and efficient regime. Industry has proposed an offshore wind Sector Deal which would include a review of market arrangements with the creation of a Taskforce to inform future grid planning and regulations for large scale systems and offshore transmission. Consumer benefits could be realised from undertaking such a review.

Our answers to the questions posed in the consultation can be found in annex 1 attached.

Yours sincerely,

Nicola Percival

**Policy & Regulations Manager**  
**Innogy Renewables UK Limited** Annex 1: Innogy's answers to the consultation questions

**Question 1:** Have we identified (in Chapter 1) the right drivers for possible change to the OFTO tender process? Are there other drivers for change we should consider?

We suggest that Ofgem should consider the ongoing ability of existing OFTOs to efficiently resolve issues arising – from an expertise, incentive and a financial perspective – as another driver for change. innogy has cause for concern that the tender process encourages a race to the bottom amongst bidders that incentivises the minimum possible management, staffing and maintenance provision in order to reduce costs in order to win the tender. Since the initial inception of the regime, and since the first OFTO was appointed, there are examples of OFTOs making inefficient repairs in terms of both time and cost<sup>1</sup>, possibly due to a lack of appropriate expertise, contacts and the incentive to do so. Such inefficiencies severely impact the generator exporting power over the transmission assets, which has no ability to mitigate ongoing risk in this regard. Ofgem should address this concern for both current and future OFTOs to ensure that the reputation of the OFTO regime is not tarnished by such issues.

**Question 2:** Are the objectives of our review appropriate? Are there any other objectives that we should consider?

We agree that the objectives are appropriate. We suggest that the first and second objectives are the most important and should be given more weighting than the latter two when considering potential changes.

Currently this consultation is highly focused on the needs of the bidders, and not the sellers (Developers). The needs of both main stakeholders in the bidding process must be considered equally. Paragraphs 2.8, 2.9 and 2.10 of the consultation document focus on bidder feedback to Ofgem regarding making the bidding process more accessible and less expensive for bidders. As a developer of offshore wind farms and associated transmission assets we are not supportive of changes which ease burden on potential bidders where these do not also demonstrate positive and tangible improvements in the ability of the bidders to operate and maintain the assets. The assets being sold under the OFTO regime are high quality, of significant value (>£0.5bn in many cases, and potentially up to £1bn in the future) and the generator connection into the asset depends solely upon the robustness of the successful bidder's operation and maintenance of the asset to export the power they generate. As offshore wind becomes an increasingly significant proportion of the generation mix the robustness of the tender process and the quality of the potential bidders that the regime attracts in terms of their ability to own and operate high volt-

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<sup>1</sup> Which have not been formally scrutinised by Ofgem. We are happy to provide further information upon request.

age transmission infrastructure that supports offshore wind should be beyond doubt. Ofgem's assessment and scoring of the quality of the bids should send a clear message to this end. We ask that Ofgem bear this in mind when deciding what, if any, changes to make to the tender process.

Objective (i) is arguably not currently being achieved to a high enough standard, and therefore a desirable outcome of this consultation should be an increased focus on ensuring that OFTOs are robust at the bidding stage. OFTO robustness must not come at the expense of loading risks onto Developers which they cannot effectively manage (please see our response to Ofgem's recent open letter consultation on Income Adjusting Event policy).

Competition is important, but in its dedication to a price-competitive bidding process Ofgem should not lose sight of the critical importance of finding the most robust and diligent OFTO owners to ensure that generators and the UK grid can rely on the highest possible availability of offshore wind power.

Whilst we support Ofgem in the aim to have a streamlined and efficient tender process, we do not support that coming at the expense of robustness of the process, and we would not want this to support a streamlined process for Ofgem whilst loading increased workload onto Developers (which some of the proposals would do, further detail below). The sale of multi-million GBP assets should be subject to the appropriate processes and scrutiny as befits their value and ongoing importance to the generator parties which rely upon their staying in good working order to be able to export cheap, low-carbon power for the benefit of consumers.

**Question 3: With respect to the existing tender process arrangements:**

- (a) Are any different or additional arrangements needed to mitigate the risk of OFTOs not being financially or operationally robust?

The existing tender process at ITT has a weighted score of 60:40 with regards to the proposed TRS value and the questionnaire results respectively, and we consider that this is a somewhat effective approach. However, now that the OFTO regime has matured, we believe that it could be improved to better assess bidder robustness and suitability to own and maintain transmission assets. Appropriate scrutiny must be undertaken by Ofgem during the bidding process to ensure that bidders have the appropriate financial robustness and expertise to be appointed as responsible owners and operators of the asset (see our answer to question 4(d), (e), (f)).

- (b) In particular, do you consider that our tender process would be robust to a Carillion-type scenario? Are there additional questions we should ask at EPQ or ITT?

Two risks are presented by the 'Carillion' scenario for OFTO wind. OFTOs are highly-leveraged entities which are in many cases inter-connected. Their high leverage means that financial overconfidence and/or marginal changes to economic conditions could result in the insolvency, and given their interconnection, an insolvency could develop into a domino effect which would have a significant impact on the sector. Secondly tender processes that focus too heavily on price will result in bidding that squeezes contingency levels and incentivises corner-cutting. This leaves bidders exposed in the event of unexpected circumstances and the occurrence of several unexpected circumstances on different assets owned by the same entity could very quickly lead to insolvency (as was the case for Carillion).

A full understanding of the OFTO's accounting policies and the level of inter-connectedness between OFTOs should be obtained at EPQ stage. Also a robust and thorough O&M strategy should be an essential part of any successful OFTO's bid.

Ofgem seemed confident at the 30th April workshop that existing OFTOs would be robust to avoid a Carillion-type scenario, but supporting analysis was not presented. We defer to BEIS and Ofgem, as the regime owners and implementers respectfully, to be satisfied that this is so through critical analysis of the ownership structure of existing and future OFTOs. As Developers innogy would be affected by a Carillion-type scenario but we have no ability to manage or mitigate the risk of it occurring for OFTOs.

(c) Do you have any other specific feedback on the existing tender process?

Innogy would welcome an emphasis on speeding up the overall tender process and reducing costs. When compared to other comparable asset sales, the process is far slower and more expensive (in terms of transaction costs) and this should be addressed. A faster and cheaper process could be achieved through removing the GCC deadline and ensuring that bidders are not incentivised to draw out and explore issues over a longer period of time knowing that the closer that the process gets to the GCC deadline, the more the balance of power in the process moves in their favour.

Question 4: With respect to the moderate change package:

- (a) Do you believe this option would be an improvement over the current tender process?
- (b) Do you agree with our assessment of this package against the objectives?

We do not believe that the changes Ofgem propose in the moderate change package would be an improvement to the tender process. The first objective, which is one of the most important of the four in our view, is by Ofgem's own acknowledgement not better met by the proposals in the

moderate change package. We do not support changes being made which do not score well against this objective (see our answer to question 3).

Regarding the second objective, Ofgem's assessment in Table 3 in the consultation is that a more complete focus on price only rather than price and robustness at ITT being a positive for consumers by keeping costs as low as possible. We disagree that this offers the best outcome for the consumer. By focusing solely on how cheap the asset can be purchased and managed for at the time of bidding the value for money aspect is not considered at all (which is more important for the consumers of tomorrow than cheapness). Demonstrating value for money should be the focus and ultimate aim of any changes made. Cheap today does not necessarily equate to value for money over 20 years and it is important that Ofgem's assessment of bids reflects that to at least the standard of TR5 if not more.

- (c) Do you consider that there are questions that could be removed from the ITT questionnaire (for example, where there is overlap with the EPQ, or where the approach is mandated elsewhere)? For what reason and benefit could they be removed?

We would support Ofgem removing duplicate questions between EPQ and ITT, but not at the expense of the robustness of the assessment process.

In the 30<sup>th</sup> April workshop it was discussed that there could be opportunity for a further workshop to discuss Ofgem's TR5 questionnaires for assessing the technical (and possibly also financial) robustness of bids. Innogy would welcome this opportunity and we await further information with interest.

- (d) Are there any amendments to this package that would improve it?  
(e) What are your views on the most appropriate ways to mitigate the challenges of this package?  
(f) Are there other considerations we should have taken into account that present practical or other challenges to implementation?

We suggest that if Ofgem do choose to make changes to the Tender Process that such changes do not mean that the only robustness assessment made is against a minimum threshold of robustness. That would not incentivise bidders to offer the highest standards, quite the opposite. Bidders would propose only enough to meet minimum standards – and it would be the generator, for whom exports depend on the transmission asset being maintained and operated to a high standard of quality, who would be exposed to the risk of poor OFTO robustness.

We support retaining **at least** a 60:40 split in the assessment criteria, indeed we propose that Ofgem consider making this split 50:50 to impress upon the bidders the importance of maintaining the asset to a high standard.

We would be supportive of Ofgem making changes to the EPQ/ITT questionnaires to make them more relevant to the mature OFTO regime, however these changes would need to score positively against Ofgem's first objective (regarding robust assets). We do not support changes which reduce the importance of the assessment of bidder robustness and suitability to be appointed as an OFTO.

If Ofgem do choose to introduce thresholds into the process then the threshold(s) chosen would need to be very high in order to maintain the integrity of the OFTO regime.

We request that Ofgem also introduce licence conditions for OFTOs which require them to submit a third-party led technical audit of their maintenance records at regular intervals (annually, once every 2 years for example). Currently the bidder's plans for maintaining the asset are assessed at EPQ/ITT stage but then never revisited to check whether the OFTO is maintaining the asset in line with their bid and good industry practise. We would also like to see similar requirements placed upon existing OFTOs through a licence change.

- (g) Where we were to allow conditionality only on particular elements of a bid, how should we take into account conditionality in bids which cumulatively raises concern about the overall robustness of the bid? Where possible, please quantify or describe qualitatively any benefits or burdens from this package of change.

We see this issue as being a side effect of the moderate change package proposals not being as robust as the current processes for appointing OFTOs. We do not support the proposals and therefore suggest that Ofgem do not consider implementing proposals for the tender process which do not improve the process's ability to score well against the first two objectives highly. The latter two objectives are not essential to the regime operating as intended.

Question 5: With respect to the significant change package:

- (a) Do you believe this option would be an improvement over the current tender process?  
(b) Do you agree with our assessment of this package against the objectives?

Please see our answer to Question 4 (a) and (b). In addition:

The consultation document suggests that Developers would be expected to undergo the full due diligence process and contract negotiation with all bidders at ITT, rather than the one preferred

bidder. There is no cap proposed on how many bidders that might be. The increased workload associated with such a change would be significant and would require Developers to keep a sizeable team available for this which would increase costs (costs which ultimately increase costs for consumers).

We fundamentally oppose the changes proposed in the significant change package for the reasons we give throughout this consultation response.

- (c) Are there any amendments to this package that would improve it?
- (d) What are your views on the most appropriate ways to mitigate the challenges of this package?
- (e) Are there other considerations we should have taken into account that present practical or other challenges to implementation?

Please see our answer to Question 4 (d), (e) and (f).

- (f) What do you think of potential bid bond arrangements, pain/gain share mechanism and consequential changes to allow efficient unconditional bids? Where possible, please quantify or describe qualitatively any benefits or burdens from this package of change.

We require more detail on these proposals which are merely sketched out as ideas in the consultation.

We support the objective of speeding up the process of executing the transaction, but if this was achieved through increasing costs (through bonds) then the net impact of the changes would have to be modelled and assessed before changes are made.

Bonding offers a potentially positive option from a developer's perspective as it could be used as leverage to ensure the appropriate behaviour from OFTOs at PB stage. Under the current regime all the leverage lies with the bidder through the ticking clock of the GCC. The effectiveness of this leverage would depend on the size and terms of the bond.

The pain/gain share proposal is difficult to appraise due to the lack of detail. Nevertheless in the scenario where Ofgem was proposing a fixed price bid to promote a quicker execution, innogy would not support a proposal that had the potential to increase to the generator's TNUoS with such agreement being settled between Ofgem and the OFTO (in the event of an unexpected increase in the OFTO's financing costs for example). It would be more advisable for Ofgem to ensure (at EPQ and ITT) that OFTOs have financing structures and resources which are robust and

at least adequate to manage fluctuations in finance markets, rather than building flexibility, uncertainty and delay into the PB stage.

**Question 6: Are there other packages of change that we should consider that would better deliver against the objectives?**

We are opposed to both the moderate and significant change packages as they are set out in the consultation. However, we are supportive of Ofgem's aim to make the tender process streamlined, more efficient and ensure it offers the best value for money for consumers. We fundamentally believe that any changes made must improve the ability of the regime to meet objectives (i) and (ii) as described in paragraph 2.2. Where changes can improve the ability of the regime to meet objectives (iii) and (iv) that is desirable, but ultimately the process must be robust and thorough to maintain the integrity of the process and so as not to damage Ofgem's reputation.

We would consider supporting a variation on the moderate change package whereby more bidders are allowed to progress to ITT following being successful at EPQ stage. Robustness of ITT assessment to appoint a preferred bidder must not be compromised in this process though, in fact we believe that the 60:40 split could be increased to 50:50 for reasons we have outlined in our responses to Questions 4 and 5.

We would not support changes which required Developers to undergo full due diligence and contract negotiation with any party other than the preferred bidder for reasons we set out in our response to Question 5.

**Question 7: With respect to the other tender process changes considered that could apply to either the current tender process or any of the potential packages for change:**

- (a) Does Vendor Due Diligence (VDD) in practice reduce the total cost of a tender process? Are there any benefits in broad VDD? Are there benefits in a more focused approach to VDD (for example a Certificate of Title)? Under what conditions and to what extent would bidders base their bid on VDD?

As a Developer innogy see no barriers in principle to providing Vendor Due Diligence or Certificate of Title as described in the consultation. However, we are aware that other Developers have experienced difficulties with both of these in practice whereas innogy has not used either to date. We therefore ask that Ofgem engage with the experience of industry in this area to date and, in the case that VDD and/or CoT are implemented as per the consultation outlines, that Ofgem ensure the required processes are in place to avoid repeat issues.



- (b) Are there other cost-effective ways in which the bidder data room could be improved to the benefit of all parties? Are there specific ways to further standardise the structure?

We are very supportive of improvements being made to the bidder data-room. This could also benefit the developer, provided there was adequate consultation on the agreed structure and some flexibility within the structure to manage documents in a bespoke fashion. Currently the data room creates work for both Developers and bidders in that it is difficult to navigate and results in large volumes of queries which could be avoided in a more user-friendly system. There is also significant scope for human error in multiple manual processes.

- (c) What changes, if any, should we consider to our current bond spread methodology? Would an appropriate pain/gain share mechanism for bond-financed bids allow us to fairly assess bond and bank-financed bids on the same committed finance basis?

Please see response to question 5(f)

- (d) Do you consider that we could adequately rely on a more confirmatory approach to questions? Are there particular documents or questions we could consider not requiring the bidder to produce, but instead confirm? Are there particular documents/requirements that are better left to the PB stage? Where possible, please quantify or describe qualitatively any benefits or burdens from this package of change.

We have no issues with Ofgem requiring bidders to make declarations in the early stages of the bidding process where these declarations do not compromise Ofgem's ability to assess the suitability of the bidder to be able to operate and maintain the transmission asset from an expertise and technical perspective. This could even allow Ofgem more time to focus on the robustness of the bidders to being responsible for owning and operating the transmission asset to a high standard. The declarations would need to be proven at preferred bidder stage.

**Question 8:** Do you think the approach of Ofgem, developers, and bidders to the tender process will need to change as projects become larger, further from shore and more expensive? What do you see as challenges from this change?

As projects become larger, innogy believes that the Tender Round approach will become more difficult to maintain without significant investment in the resources Ofgem has to manage OFTO

processes. It would be advisable to appoint discreet well-staffed teams to work on OFTO sales individually. This approach would ensure that timelines of the OFTO process could be easily matched with the project programme and would ensure that investment opportunities are brought to market sequentially so the finance market remains liquid.

Undoubtedly the technical robustness and suitability of the OFTO becomes increasingly important as projects become larger, further from shore and more expensive. Different skills may even be required for operation and maintenance of these assets. Innogy believe that the best way to impress upon the bidders the importance of maintaining these assets to a high standard is to adjust the assessment of the TRS : robustness from 60:40 to 50:50.

**Question 9:** With respect to end of revenue term arrangements, where there continues to be a need for the OFTO, what factors should be taken into account when making decisions on OFTO revenue at the end of the normal 20 year term? When should we begin to make these decisions?

There are well defined processes for reviewing life extension for structural assets existing for oil and gas sector and being increasingly used in offshore wind applications. Innogy recommends that these processes are investigated and/or 'best practice' referred to in any licence documents to ensure that the door is left open for life extension.

The process for reviewing potential life extension for the equipment on the substation platforms (particularly safety critical) might be more complex. Again innogy suggests that Ofgem refrains from being too prescriptive about review processes and timing, and rather refers to best available practice current at the time.

We would welcome further consultation/information from Ofgem on this particular topic in the next 12 months. We would particularly be keen to understand the legal implications of re-tendering considering that current OFTOs are being paid decommissioning costs as per their bid in the TRS. Where the transmission assets are then re-sold how is this effective over-recovery from the consumer accounted for? We, the Generator community, would welcome engagement ahead of the consultation being written when Ofgem begin to form their minded-to positions. Generators and OFTOs are both important stakeholders to this issue, and one should not be consulted where the other is not.

**Question 10:** Is there demonstrable evidence that we should consider changing the default revenue period away from 20 years for If so, what would be the most appropriate revenue period?

Innogy's view is that as the expected lifespan of offshore generating assets changes so too should the licence period. We would be supportive of setting this on a case by case rather than a fixed basis. Offshore generating assets are not to be considered as one asset, but rather as a collection of assets which have different lifespans. Therefore the Developer of a specific offshore generating asset is best placed to make the case for the lifespan of the licence period ahead of tender rounds for that asset. We would be happy to engage further with Ofgem on this topic as part of their own analysis.