



BY EMAIL:

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22 January 2021

Dear Daniel Baker,

Ref: RWE's response to "Offshore Transmission Owner (OFTO) Regime Tender Process – Consultation concerning developments to the tender process within the current OFTO regime"

About RWE

RWE is a leading energy player with four main operating companies, of which three are active in the UK, including the newest subsidiary RWE Renewables, which is one of the world's leading renewable energy companies and the second largest offshore wind developer in the world.

In the UK, RWE employ over 2,600 people and generate enough power for over 10 million homes, with a diverse portfolio of onshore and offshore wind, hydro, biomass and gas across England, Scotland, Wales and Ireland. For a broad picture of the scale of our projects in the UK and Ireland, please see our infographic [here](#).

RWE have made ambitious commitments to increase the generation of clean, reliable and affordable electricity. Alongside the ambition to be carbon neutral by 2040, we continue to invest heavily in wind power and other emerging technologies, such as hydrogen and floating offshore wind. RWE's planned gross growth capex spend 2020-2022 will be €8-9bn globally, of which around 30-35% will be in the UK, mostly on offshore wind, including Triton Knoll and Sofia. We have set our sights high, envisaging RWE will play a key role in developing the energy world of tomorrow and driving progress towards the UK's net-zero ambitions.

RWE welcomes the opportunity to respond to this consultation.

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Our response

PART A Questions

Section 2 Tender Process Changes

Data Room

2.28 Would allowing earlier access to the developer's data room assist bidders?

RWE does not object to allowing ITT bidders earlier access to the data room. In practice, the data room is uploaded several months before the ITT process commences. However, to facilitate this change Ofgem would need to run the EPQ process earlier, as currently the short-list of bidders is only announced one or two weeks before the ITT process commences.

RWE does not agree to allowing all EPQ bidders access to the data room. The documents contained in the data room are commercially sensitive. We therefore wish to limit access to viable bidders identified through the short-listing for the ITT process.

2.29 What would indicate that the data room is more complete/contains the necessary finalised documentation to enable the ITT stage to commence and what would assist/improve pre-tender submission due diligence?

The key contractual documents are available well in advance of the commencement of the ITT process. For Triton Knoll the majority of the project documentation will be uploaded to the data room by the end of January 2021, to assist with the cost assessment process. This is almost three months prior to the ITT commencement. We will continue to upload documents as they are finalised, including maintenance records and any operational issues that may arise on the assets. To this end, the data room is never 'complete' as documents will continue to be uploaded to it throughout the transaction process.

As-built documentation will generally not be available until at least three months after the respective works are completed and therefore all as-builts may not be available at the commencement of the ITT process. However, the majority will be and it seems unreasonable to delay for these documents as they may take longer than three months to produce and it will be clear from other contractual documentation if there have been any variations to the design of the assets.

The improved search facility in the Ansarada data room should assist with bidders due diligence. It may also be helpful if a facility could be introduced to flag new documents.

Site Visits

2.30 Would it be viable or practical for site visits to both offshore and onshore substations to be conducted as part of the tendering process and would it assist due diligence to reduce uncertainties and improve the firmness of bid pricing? In

the event that this is not viable or practical, what could be done in advance of bidders submitting their tenders to deal with this issue in a pragmatic way?

Site visits on the scale proposed are not viable. Under the current tender process that could amount to up to eight parties requiring site visits. They are a considerable cost and highly impractical.

For example, RWE's next project, Sofia, is 195km from shore. Accordingly, maintenance will be conducted from a service operation vessel that remains in the vicinity of the wind turbines for two weeks at a time. This is the only vessel used to access the wind farm and it takes 15 hours to travel to site from shore. Further, any person visiting the offshore substations must undergo rigorous safety training.

In any event, we do not consider this would improve the firmness of bid pricing. A site visit provides an external visual assessment of the assets and in our experience only minor issues have been identified at site visits, which would not materially impact a bid.

Cost Assessment

2.31 Would there be a benefit to moving the timing of the cost assessment process so that the ITT bid phase is delayed until all costs (bar settlement of claims and/or future costs yet incurred) are settled? What are the risk of doing so and how might these be mitigated?

We strongly disagree with the proposal set out in sections 2.15 and 2.16 of the consultation document for the reasons stated below. The ITV is currently occurring when detailed cost information is available but this has not assisted with finalising the FTV earlier. We consider it is primarily inefficient practices that are delaying the finalisation of the FTV.

We consider that both the ITV estimate and FTV assessment could and should commence significantly earlier than they currently commence within the current tender process timetable. The Tender Regulations require that the ITV is completed by the time the assets are 'available for use'. This has not been achieved on a number of RWE projects.

For example, on two of RWE's recent projects the ITV process was commenced when the trigger point for commencing an FTV assessment, as stated in section 2.16 of Ofgem's Cost Assessment Guidance, had already been achieved. Thus, the FTV could have commenced at that time, whereas Ofgem did not commence the FTV assessment until almost 12 months after the point at which Ofgem's guidelines state the FTV should commence.

We consider the FTV process should be run when the current ITV process is run and the ITV process should be run significantly earlier when it is an estimate of the

project costs. The ITV should focus on what costs are allowable and on agreeing the contracting strategy and allocation keys. The FTV then focuses on the actual costs. We consider these changes could be made without amendment to the current timing of the ITT process. It would be unacceptable to delay the commencement of the ITT process beyond its current alignment with National Grid's issue of the completion notice because this would reduce the GCC period available to negotiate the transfer agreement. A full twelve months is required for the negotiation stage of the transaction should any issues arise with the assets and negotiation of indemnities is required.

In addition, we consider that the organisation and efficiency of the Ofgem cost assessment process could be improved to the benefit of all parties. RWE strongly encourages Ofgem to provide developers with a clear cost assessment timetable and set out what the developer is required to provide for each stage of that process at the project qualification stage of the tender process. This will enable developers to proactively provide the necessary information rather than reactively responding to Ofgem's requests once the process has commenced. This would create a smoother and more predictable process for all parties.

Further, for the efficiency of the process, Ofgem needs to commit to its own timelines and raise all proposed disallowances with a project before releasing its proposed FTV. The FTV assessment for another RWE project has taken in excess of 12 months and Ofgem has issued seven draft versions of the final FTV assessment, each with new proposed disallowances. This is highly inefficient and particularly frustrating for RWE when new issues have been raised on each occasion for matters that we understood were settled.

Introducing new cost assessment policies mid-way through a cost assessment process is also inefficient and unreasonable given developers will not have had any opportunity to take these policies into account in developing the qualifying project. As these new policies have not been consulted on, disputes can arise over their validity, which can also cause delay.

We note in this regard Ofgem's statement at section 1.15 of the OFTO Regime Tender Process document for this consultation, "*We believe consultation is at the heart of good policy development*". Considerate follows that cost assessment policies should be developed and consulted on before being introduced in the same way that the tender process policies are consulted on. It is unclear why there is this inconsistency with the development of new cost assessment policies, as the cost assessment process is an element of the broader tender process. We note also that cost assessment policies were consulted on in the early days of the OFTO regime.

Transfer & Interface Agreements

2.32 Would respondents support Ofgem's proposals to delay the submission of ITT bids until the transfer and interface agreements are substantially concluded, with Ofgem delaying the submissions of ITTs until such time as they are considerably more advanced?

We do not support Ofgem's proposal to delay the submission of ITT bids as described in section 2.18 of the consultation paper. This proposal serves to limit the time available to the developer and preferred bidder to negotiate the transaction documents without reducing the scope of that task in any way.

The transfer and interface agreements are already substantially concluded at the commencement of the ITT process. Any gaps are where information is not yet available and the only amendments that occur after this date relate to new issues arising (possibly identified through confirmatory due diligence) or from amendments proposed by and negotiated with the preferred bidder.

Bidders' positions are not necessarily consistent and therefore any changes that a developer makes to the transfer agreement in response to bidders' comments at the ITT stage will not address all bidders' concerns.

In our experience the PB will seek to amend the transfer agreement at the PB stage irrespective of how 'final' the developer considers it is. A developer may be prepared to alter its position if it is of no detriment to the developer. RWE's concern is that a situation could arise where the developer does not wish to alter its final position but it is forced to accept an uncommercial position because the preferred bidder uses the GCC deadline to its advantage. More certainty would be achieved if Ofgem were to enforce the terms of the 'final' version of the Transfer Agreement provided at the ITT stage, which bidders are required to base their bids upon.

It is unacceptable to delay the timing of the ITT process. A full twelve months is required for the negotiation stage of the transaction should any issues arise with the assets and negotiation of indemnities is required. Realistically a 12 month period for the transaction stage only allows six months for negotiation when you take out the lengthy time required for the statutory processes and lenders confirmations.

2.33 If so, what could Ofgem do to ensure that it is effectively managed without needing much extra time in this phase?

As stated above, if Ofgem was to enforce the final version of the Transfer Agreement provided at the ITT stage, which bidders are required to base their bids upon, this would reduce the number of issues that reach an impasse in the negotiations.

In the Invitation to Tender for Tender Round 5, Ofgem state at section 1.22 that *“Qualifying Bidders will be required to make their ITT submissions based on, and assuming that, there will be no further changes to the Final Project Transfer Agreement”*, and that TRS bids must be priced on that basis.

We consider that Ofgem’s position set out in section 1.22 of the TR5 ITT document should be strengthened in the TR7 ITT document to make it clear that this is a ‘tender rule’ for the purposes of regulation 27 of the Tender Regulations and that bidders can be disqualified from the tender process for a material breach of a tender rule. Further, the rule should also be stated in the Tender Process Guidance Document, which has replaced the former Tender Rules document.

We encourage Ofgem to be more robust in its approach to facilitating the tender process and take a more hands on approach, where appropriate, when requested by the parties. Ofgem’s position in the recent past on this matter has been to consider that disputes that arise over the Transfer Agreement are commercial issues between the developer and PB, and to refuse to get involved, despite this contravening Ofgem’s own rule in section 1.22. This is particularly frustrating for developers given the unique nature of the negotiating environment. In a normal commercial transaction a developer can walk away. However, in a regulated transaction it cannot and the GCC provision can result in an unfair power imbalance. We therefore strongly encourage Ofgem to uphold a fair negotiating environment and intervene where disputes arise, in the capacity of referee, and as appropriate enforce the stated rules.

Further, it is not uncommon for a PB to maintain a position because, “it was in our bid”. However, developers do not see the bids and are not consulted on their contents. Therefore it cannot be assumed that all aspects of the winning bid are acceptable to the developer, particularly where they are contrary to the position stated in the Transfer Agreement. It should to be made clear to bidders that all aspects of their bid are not automatically accepted.

Any delay in the transaction resulting from enforcement action will require a corresponding delay to the GCC date.

2.34 **If not, what could be done in the alternative in order to provide bidders with the necessary certainty from a pricing perspective, without doing so to the consumer detriment, and also expedite the conclusion of finalising the necessary transaction agreements?**

Invariably it will be the negotiation of indemnities for technical issues that delay the finalisation of the transaction. For known issues, the relevant information should be included in the data room so that bidders bid with full knowledge of any existing technical issues and what commercial cover, if any, is provided. For technical issues that arise at the preferred bidder stage these will take significant time to negotiate

taking into account the time required to investigate the issue and obtain the necessary technical analysis and expert opinions, as appropriate.

RWE is committed to providing information on any project issues that we consider will be of interest to bidders at the ITT stage so that these issues are included in the pricing assumptions of the OFTO bidders and are dealt with expeditiously at the transaction stage.

Evaluation Approach:

2.35 Would respondents support in principle a qualitative assessment of all elements of a bidder's bid with each section forming part of the overall evaluation score, and why?

We are not in agreement with Ofgem's proposal for a pure qualitative approach to bid evaluation set out in section 2.19 of the consultation paper. This will not provide maximum value to consumers.

A qualitative assessment is not the most cost effective approach for all elements of a bid. From RWE's perspective the weighting between price and quality is directly dependent upon how clearly the scope of what is required is outlined. RWE's concerns with the current approach is that the tender evaluation is 100% weighted on price without stipulating in the threshold requirements clear maintenance and operational standards that ensure the longevity of the assets. If it is clearly outlined what is required of bidders with respect to certain elements of the bid it is appropriate to assess such elements on a pass/fail basis and leave the dominant portion of the bid score weighted on price.

We consider stipulating standards is the most appropriate solution to achieve the desired performance of the assets with respect to the operations and maintenance, emergency response plans and decommissioning elements of tender bids, to name a few. It is not innovation that is being sought for these elements of tender bids but rather an assurance that accepted OFTO functions are performed to an industry recommended level of regularity and quality. Notably a desirable level of maintenance standards was not achieved as a matter of course when the evaluation criteria included a qualitative element in earlier tender rounds.

With respect to O&M standards, Ofgem could use independent quality standards where available or the maintenance standards stipulated by the manufacturers of the assets. For emergency response plans these could be developed in consultation with developers and decommissioning standards are already stipulated by BEIS. We also suggest that Ofgem puts in place an appropriate monitoring programme to confirm that OFTOs are performing O&M in line with the stipulated standards over the lifetime of the asset.

A pure qualitative approach is likely to result in significant TRS increases without any assurance that the assets will be maintained to the standards stipulated by industry to achieve the desired performance. The subjective nature of such an assessment will also make it more vulnerable to challenge, which has significant cost and time implications for all parties involved.

In summary we consider stipulating standards for certain OFTO functions, particularly O&M, will: be the most cost effective solution for consumers; ensure the desired performance of the assets and provide a transparent and level playing field for Ofgem to assess the bids.

2.36 Would doing so lead to bidders proposing engineering solutions that come at high consumer cost for marginal (if any) consumer benefit when compared to robust, yet less costly alternatives?

Potentially and there is no certainty that the desired performance will be achieved.

2.37 Could such an approach deliver more environmentally conscientious approaches to operations and maintenance?

Stipulating standards does not preclude an environmentally conscientious approach. These could be achieved at the initiative of the OFTO or stipulated within the required standards.

Funding

2.38 Do respondents consider that deferring debt finance to the PB stage could open up the market to more sources of finance and drive better value for consumers, including Green Finance and, if so, what benefits would that bring to consumers?

RWE does not support the proposal to defer debt financing until the preferred bidder stage.

Without confirmed debt financing OFTO bidders will not be able to make binding bids. This uncertainty is likely to lead to higher pricing because there is no opportunity to tease out whether lenders have concerns with the project.

It may also result in the winning bidder having higher priced debt than other OFTO bidders would have achieved.

We consider the current arrangement offers suitable flexibility for lenders given the allowance for market rate adjustments. Further, the certainty of secured funding maximises the likelihood that the transaction will finalise at the most competitive price and is therefore in the best interests of consumers.

2.39 Would deferring debt funding competitions until the PB is appointed reduce the costs of bid preparation and be attractive to new equity investors?

Deferring debt funding competitions until the PB stage may reduce the cost of preparing a bid but it will substantially increase the risk of the preferred bidder not obtaining debt funding and, where it does obtain funding, obtaining it at a higher price than its assumptions.

Conversely, there is the potential for a PB to obtain cheaper debt than its ITT assumptions but in such circumstances this is likely to result in the OFTO obtaining greater margins.

It follows that consumers would bear the financial risk for such a proposal and therefore we do not consider it is in consumers' interests.

We consider the OFTO market is sufficiently mature to attract new equity investors at the ITT stage. Similarly, the growth in green financing supports the financing of the OFTO market.

2.40 Would securing funding later in the process have an impact – positive, negative or none – on the overall time to conduct the tender and transaction process?

Securing funding later in the OFTO tender process will negatively impact the time available to complete the OFTO transaction, which for the reasons stated above should not be reduced. We estimate a full debt funding process will take up to six months. This is considerably longer than the 8-10 weeks currently allowed in the PB stage of the transaction for the preferred bidder to confirm its financing.

It may be possible to run the debt financing process in parallel to the negotiation of the transaction documents. However, because of the uncertainty of this process and the likelihood that it will not achieve the best price we do not support its adoption.

Reserve Bidder

2.41 Should Ofgem exercise its powers to withdraw the appointment of the PB where deadlines are not met?

As this is a regulated transaction, we consider it is appropriate that Ofgem takes a more active role in the management of the tender process, including time management. We expect this would include reference, where applicable, to disqualification under regulation 27 of the Tender Regulations, as we have set out in our response above. However, disqualifying a PB and replacing it with a reserve bidder would bring considerable risk of breaching the GCC deadline unless the GCC deadline is simultaneously extended to compensate for the delay such an appointment would cause to the negotiation process. The negotiation of the transaction documents and confirmatory due diligence process would effectively

start again. Additional transaction costs would also be incurred and would need to be allowed for under the cost assessment process.

Without a simultaneous extension to its GCC deadline, a reserve bidder is ironically placed in an even stronger position than its predecessor to negotiate the transaction in its own interests given the proximity to the GCC deadline.

With a GCC extension, the threat of the replacement of a reserve bidder becomes a useful stick to ensure the negotiating environment remains fair for all parties and could assist to balance the commercial positions of the parties in light of the GCC.

2.42 Should Ofgem set a deadline by which all confirmatory due diligence and/or final approvals from funders must take place?

Yes, we consider Ofgem should be more explicit in setting and enforcing the PB matters. It is in the interests of all parties that projects are administered efficiently and are concluded in the shortest time reasonably possible.

We also consider the Tender Rules should be clearer, and more precise. We encourage Ofgem to revise these such that they reference the applicable tender regulation and the potential consequences of breach.

The tender process is a regulated transaction and Ofgem should administer it accordingly to ensure it is fair for all parties throughout the negotiations.

2.43 How could we ensure it is not the developer that is behind delays leading to deadlines being missed?

It is not in a developer's interests to delay the completion of the transaction. A developer is subject to criminal sanctions should it breach the GCC deadline. In addition, the project shareholders are eager to receive the sale funds for the OFTO assets as a lump sum cash payment is of greater benefit than the return obtained whilst operating the transmission assets.

Further, the closer the transaction gets to the GCC date the less leverage a developer will have in its negotiations with the preferred bidder.

2.44 What considerations would be needed to maintain the ability of the reserve bidder to mobilise quickly?

A reserve bidder's financing, O&M and insurance proposals would need to remain current during the life of the transaction. Further, it would need to ensure it has the resourcing to complete the transaction at pace.

Section 3 Reference Interest Rates

3.6 Is your expectation that SONIA -based products will be used for TR7?

Yes, if the OFTO is raising debt finance, the debt finance will be based on SONIA. From 31 March 2021 banks are not allowed to enter into new loans that are LIBOR based and from Q3 onwards not allowed to enter into swap or other derivative deals that are LIBOR linked. For Sterling loans, these need to be based on SONIA going forward.

3.7 What do you consider would be the most appropriate information screens to be used by Ofgem to inform ITT assumptions and benchmarking? Please provide examples/evidence to back up any preferences.

Not answered.

3.8 How do you expect bid margins and charges to SONIA to differ to those bid to LIBOR?

Not answered.

Section 4. CPI or RPI indexation of revenue

4.6 For OFTO projects, would a switch to CPI/CPIH or the addition of CPI/CPIH as an alternative option impact on your strategy for revenue indexation and, if so, what would the impacts be?

RWE support the switch to CPI rather than RPI from TR7. The main reason for this is that all projects that are going through the OFTO process are now CfD projects instead of ROC projects. ROCs were linked to RPI, whereas CfD revenues are linked to CPI. Moving to CPI would reduce the risk for CfD projects and further facilitate better financing conditions.

Furthermore RPI is set to phase out in the UK, with all public spend gradually moving over to CPI. Therefore CPI will become the more liquid index which would also reduce risk from an OFTO perspective, as hedging instruments become easier in CPI than in RPI.

We don't think the OFTO should have a choice of index, as it similarly affects the developer. Therefore a firm switch to CPI would be welcomed.

4.7 In your view, would CPI/CPIH-linked indexation result in a net benefit or cost to consumers?

OFTOs will price in the expected indexation and therefore on its own this would not come at a cost or benefit. However, as RPI will become less liquid, there will be benefits from using the more liquid CPI index which facilitates financing, including hedging instruments and mitigating long term risks.

4.8 What challenges could you foresee that a change of index or the addition of an alternative indexation option could bring? How would you suggest that any challenges are overcome and/or mitigated?

The indexation needs to be clear from the commencement of the ITT process to ensure the maximum alignment between the basis for costs and revenue. We do not foresee challenges provided the index is consistent across the duration of the OFTO revenue term.

Section 5. Approach to Insurance Requirements

5.7 What are your views on the ITT evaluation continuing to require bidders to take out LEG3 or an equivalent package of cover in ITT bids, or do you consider it would be preferable to allow bidders to decide on the risks that they regard as acceptable?

Ofgem states in its IAE Policy Decision Document at section 3.24 that “*This [LEG3 insurance cover] is also a requirement under the Crown Estate Lease*”. It follows that bidders are required to procure LEG3 insurance by operation of the Crown Estate Lease.

We understand that the Crown Estate Lease also provides that a Crown Estate lease holder will not be required to take out the specified level of insurance cover to the extent that such insurance cover is not available in the European insurance market on commercially reasonable terms or is only available at uneconomic rates. This is consistent with Ofgem’s own definition of ‘uninsurability’ in its IAE policy. It also recognises that the offshore insurance market continues to contract and as a consequence insurance premia are increasing significantly.

Thus, any level of insurance prescribed by Ofgem will need to be consistent with that specified in the Crown Estate Lease and the policy must be sufficiently flexible to accommodate situations where insurance is not available, in whole or in part, on commercially reasonable terms.

Where insurance is not available on such terms, Ofgem must ensure that bidders have the financial ability to repair all faults that could arise on the transmission assets during the course of the OFTO’s initial revenue term (including multiple faults). To this end bidders will need to increase the size of their cash reserves and/or obtain parent company guarantees to ensure they remain compliant with their OFTO

Licence obligations including to provide transmission services and minimise the effect and duration of any Transmission Services Reduction.

Any assumption that developers will indemnify the OFTO for risks that would otherwise be covered by a LEG3 insurance policy, including latent defects, is unacceptable. Alternative arrangements must reflect standard commercial divisions of responsibility as noted at paragraph 3.8 of Ofgem's IAE Policy Decision document dated 28 November 2018:

"The overarching premise of the offshore regime, in relation to the generator build model, is that the developer bears the risks associated with the construction of the transmission assets. In contrast, the OFTO is responsible for owning and operating the transmission assets from the point of asset transfer, and for the associated risks arising from ownership of the assets. The offshore regime was not designed to insulate OFTOs from all risks, such as a latent defect, that could be traced back to the construction of the assets."

5.8 Should the ITT requirements be more prescriptive about some elements of the insurance cover – and if so, which aspects and what benefits would this bring?

Any insurance requirements should remain at a high level and contain sufficient flexibility to accommodate situations where the prescribed level of insurance is not available on all or part of the transmission assets.

Ofgem is not an expert on OFTO insurance and therefore is not best placed to advise on the particulars of insurance packages nor what is available in what is a dynamic insurance market. We have witnessed further hardening of the insurance market over the previous 12 months due to the unprecedented number of natural disasters in recent years. This has resulted in a reduced number of insurers in the offshore market place, increased premiums and deductible periods. The current covid pandemic may further impact the insurance market.

Business interruption ("BI") insurance will generally only be available with a LEG3 insurance policy. We consider Ofgem should evaluate the cost of all new OFTOs taking out such insurance, and the subsequent increase to the TRS of such OFTOs, against the likelihood of occurrence of Exceptional Event claims in excess of 75 days for those OFTOs. Our understanding is that 75 days is likely to become the deductible period for BI claims for future OFTOs. To this end, we consider it is unlikely to be in consumers' interest to require bidders to take out a BI policy. However, we do consider Ofgem needs to scrutinise Exceptional Event applications more closely to ensure the assets are repaired efficiently and in line with good industry practice. The more prescriptive OFTO insurance requirements become, the more difficult it is for bidders to be and remain compliant with ITT requirements; and to develop innovative and cost effective solutions. That said, Ofgem remains responsible for ensuring at the ITT stage of the tender process that OFTOs have sufficient cover in

place to ensure they are able to comply with all of their OFTO Licence obligations during their Licence term.

Yours Sincerely,

(by email)

Nicola Percival

Senior Regulatory Affairs Manager

RWE Renewables