

Consultation on initial proposals for an OFTO Build model to deliver non-radial offshore transmission assets.

Clara Semal
Director of European Offshore Development
National Grid Ventures
Ventures House, Warwick Technology Park, Gallows Hill
Warwick
CV34 6DA
clara.semal@nationalgrid.com

Ofgem
10 South Colonnade
Canary Wharf
London
E14 4PU

Wednesday 29 May 2024

Dear Ofgem,

National Grid Ventures (NGV) welcomes the opportunity to respond to Ofgem's consultation on initial proposals for an offshore transmission owner (OFTO) build model to deliver non-radial offshore transmission assets.

NGV, together with European partners, successfully operates six point-to-point (P2P) interconnectors between Great Britain (GB) and mainland Europe. Further to the existing fleet of P2P interconnectors, NGV is developing offshore hybrid asset (OHA) projects – including the Nautilus project connecting from GB to Belgium and the LionLink project connecting from GB to the Netherlands.

NGV has experience in offshore development and the challenges of integrating offshore transmission with interconnection and as such, has relevant expertise to offer to this consultation; National Grid Plc, of which NGV is part, also has experience in offshore coordination as part of the Detailed Network Design exercises resulting from the Holistic Network Design, demonstrating the ability for a party independent of generators to identify best value network solutions for consumers.

NGV welcomes the progress that Ofgem and DESNZ have made in developing the regulatory framework for OHAs and building on experiences of the existing OFTO regime and hopes that this progress can be carried forward. NGV is responding to this consultation as it will help to shape the direction of travel for coordinated offshore transmission alongside the Centralised Strategic Network Plan (CSNP) and Strategic Spatial Energy Plan (SSEP), which together should further enable the UK's offshore wind ambitions and deliver value for consumers.

NGV's intention through this consultation response is to demonstrate the need for an integrated, coordinated approach to offshore infrastructure development, which considers the OFTO build regime alongside alternative and complementary possibilities – such as multipurpose interconnectors (MPIs) – to deliver an offshore planning solution which most efficiently utilises available resources alongside our European counterparts. Ofgem should ensure that any offshore regulatory frameworks – such as for MPIs and OFTOs – work harmoniously to deliver intended outcomes.

Summary of Views:

NGV recognise and support the benefits outlined in relation to an OFTO build model, whilst simultaneously recognising its associated challenges. NGV's position is that;

- the proposed generator-led mechanism for design, consents, and procurement is unlikely to work as expected in-practice; there will be a significant amount of emphasis placed on generator coordination, which unless led by a central, impartial and independent entity is likely to cause fundamental challenges;
 - if the main purpose of the proposed OFTO build model is to enable coordination and harmonisation across generators for non-radial connections, an OFTO is best placed to act as an independent integrator to mitigate different conflicts of interest which may arise between generators;
 - if a single generator is responsible for coordinating and submitting the required planning consents for the OFTO transmission cable, complexities and risks could occur to hinder progress – such as the need to coordinate timings across different consenting applications and to justify additional transmission capacity in-advance of having visibility of future connections – these examples could result in a generator having stranded assets, if projects expecting to connect to the same transmission cable are abandoned, delayed or materially modified.

- the earlier that an OFTO can be involved in the process, prior to or during detailed design stages, the more efficient the outcome is expected to be, both in terms of GB coordination and coordination thereafter into the rest of Europe through OHAs;
 - earlier involvement in the process by the eventual OFTO should also serve to de-risk design, consents, construction, and future operations, as the OFTO can better coordinate across multiple generators to better serve the needs of the different assets, for example by offering an independent and impartial view on detailed designs.

- underpinning the success of an OFTO build model is early supply-chain mobilisation; ensuring that the supply-chain is aware at an early-stage who their delivery partner is, what their scope of works is, and certainty that the works will proceed via early-stage contractual commitment is necessary to ensure efficient and effective delivery of assets;
 - a risk of the proposed generator-led procurement approach, is that in lieu of knowing who the eventual OFTO will be, the supply-chain is likely to build risk premia into any bid submissions – or worse, be disincentivised entirely from involvement in the OFTO build process, given the volume of work available to them in other markets – which in-turn could counteract any consumer savings the OFTO build regime seeks to create;
 - there is a further risk in this respect that should a generator-led procurement approach be implemented, the successful OFTO will inherit pre-awarded contracts for associated works, which could create inefficiencies and impact deliverability owing to its complexities – hence NGV’s view is that OFTO-led procurement is the more feasible option;
 - NGV equally recognises that an OFTO-led procurement approach could cause concern and increase risk for generators, such as the need to await license approval prior to awarding supply-chain contracts; however, NGV’s view is that any involved risks can be mitigated with appropriate planning and that the benefits of an OFTO-led approach far outweigh its potential drawbacks.

- under the OFTO build regime, there is more risk exposure for OFTOs – such as those mentioned within the consultation in relation to funding mechanisms, construction, and supply-chain – than under the existing OFTO regime, and so there must be an acceptable risk versus reward balance for prospective OFTOs which mirror the allocation of roles and responsibilities;
 - risks on the OFTO will be inherently greater than under the existing OFTO regime, a dynamic that must be reflected within underlying commercial principles in order to incentivise suitable market liquidity and timely delivery of assets;

- the above is likely to be particularly true during the first tender rounds of the OFTO build model, where a different risk profile of a novel delivery model could impact outcomes, unless roles and responsibilities are clearly defined and underlying commercial principles suitably incentivise prospective OFTOs.

- cost increases during the development and construction of an OFTO's assets need to be reassessed through a mechanism that maintains viability for the OFTO, whilst simultaneously still being in the best interest of consumers;
 - failure to establish such a mechanism could mean that risk premia are included within an OFTO's tender revenue stream (TRS) to counteract an inability to recoup future cost increases, or the risk becomes too significant for prospective OFTOs and participation is discouraged thus weakening competition; both scenarios would undoubtedly be detrimental to consumers.

- the regime and tender evaluation criteria need to be attractive to, and value, OFTO bidders who can add economic value through more than only financial structuring – such as by adding value through effective design, efficient procurement, delivery confidence etc.
 - a regime that overly focuses on financing should be avoided, as this will result in projects with high levels of debt/low levels of equity investment, thus increasing the risks should financial market conditions change, which in turn could result in OFTOs seeking to exit the market due to financing structures no longer being sustainable; this is counter to the need to attract long-term OFTO operators in a growing market.

Section 1 – Procurement

1. Which party should be responsible for procurement in the late competition OFTO build model and why?

NGV appreciates the respective benefits and drawbacks of the different procurement approaches available, but believes that an OFTO procurement approach would provide the greater end-to-end solution benefit, enabling the OFTO to be involved in the development process earlier. However, several points would need to be true in order to unlock any benefits, such as;

- the tender process must be configured such that the successful OFTO could, as a minimum, influence detailed design, which is not currently envisaged as part of tender timings;
 - similarly, if the successful OFTO is unable to, at minimum, influence early-stage asset development, then operational aspects – such as maintenance, repair and overall operability – may be considered excess, leading the generator(s) to build the most cost-efficient solution from an upfront construction perspective but neglecting long-term requirements.

- there would need to be clear allocation of risks between the OFTO and the generators via clear linkage between the generators' terms and conditions and the OFTO's terms and conditions, with regard to cost increases during construction, delay damages etc.
 - as referenced within the consultation, unless risks are clearly and fairly attributed, there is a risk that the OFTO build model will not be viewed as an investible proposition for prospective OFTOs.

- bringing the OFTO in earlier within the development process can serve to de-risk supply-chain challenges, as works can be awarded earlier than otherwise would have been the case; overall experience demonstrates that the supply-chain requires significant early financial commitment to ensure timely delivery;
 - earlier OFTO involvement could create similar benefits from a consenting perspective also; with legal consenting challenges becoming more common, there should be an incentive for the eventual OFTO to hold an active role in consenting activities to de-risk the process, which is likely easier to achieve if OFTOs are involved earlier within the development cycle;
 - supply-chain engagement also suggests volume is of importance to suitably incentivise suppliers; Ofgem should consider how this can be established within the OFTO build regime, to ensure projects are of a suitable size, scale and volume to incentivise supply-chain participation.

If a procurement exercise is ran later in the OFTO tender process, i.e. after detailed design and consenting stages, then the generators should retain responsibility for this aspect of the process, as the OFTO will have had limited influence on detailed design and consenting approaches and therefore ultimately be tendering for works which they were not involved in the scoping of. If the involved generators are responsible for the procurement exercise, then this will require a robust contractual handover between the generators and the OFTO, which could result in risk premia being added to OFTO bid submissions. NGV fails to understand how a generator-led procurement exercise would work in-practice and feels that generator-led coordination will lead to unforeseen challenges, so believes that pursuing this route is unlikely to achieve the intended outcomes.

NGV's view is that a generator-led procurement approach would create complexities owing to a need for both reliance and coordination between connected generators in relation to design, consents, supply-chain engagement etc. which will be challenging to achieve in practice, alongside the additional contractual complexities it causes. Equally, generator-led procurement faces the risk of focusing on upfront capital cost efficiency but neglecting longer-term operational cost impacts, such as those relating to maintenance, repair and overall operability etc. Overcoming these complexities is part of the rationale behind evolving the existing OFTO regime for non-radial connections, hence NGV's view that an OFTO-led procurement approach would be the most beneficial option, in part because of the independent and impartial view that will be offered as well as the fundamental challenges in terms of coordination should the procurement be led by generators rather than by a central, impartial entity that can integrate a range of generator views – such as the OFTO.

Section 2 – Tender Process

2. At what point should the OFTO tender process commence? Does option 1 (Tender commences at consent grant) or option 2 (Tender commences at consent submission) present the best approach?
3. Do you agree with the view that, providing stakeholder engagement is properly conducted ahead of consent submission, generators should have a reasonably clear view, at the time of consent submission, as to whether the consent is likely to be granted in the form requested, and that an OFTO would be comfortable to submit tender bids on this basis?

NGV's view is that option 2 presents the best approach of those outlined, as it allows the successful OFTO to influence and support consenting processes for the OFTO transmission cable, consequently creating a more coordinated solution. If option 1 is implemented, then the successful OFTO has limited scope to influence and support consenting processes, which could prove to be prohibiting and lead to a less coordinated solution. However because of the uncertainty option 2 involves, Ofgem should consider the following points:

- consideration should be given to whether OFTO bidders are remunerated for the costs involved in their bid submissions, capped at a certain monetary threshold and providing suitable evidence exists, should the tender process be abandoned or materially changed as a result of several pre-defined reasons.
- OFTO bidders must, as a minimum, have transparency of the parameters of the consent submission, with any changes made as a result of planning consents processes made visible to OFTO bidders.

Notwithstanding the above, as established in prior sections, both options are considered too late to enable effective coordination amongst the involved generators, as compared to an OFTO coordinated approach. In both scenarios, a successful OFTO will be awarded past the point at which they are able to support the detailed design process for their transmission cable, making the OFTO beholden to important design decisions made between the involved generators and without their involvement. This is likely to result in suboptimal outcomes and increase risks from an OFTO's perspective, which may lead to increased TRS requirements to cover involved risks or worse, entirely disincentivise OFTO participation.

NGV notes the suggestion that effective stakeholder engagement on behalf of generators could serve to mitigate consenting risks, but believes that effective stakeholder engagement is only one aspect of the consenting process which alone fails to mitigate the ever-present risks of material changes to, or a rejection of, the consents application, consequentially effecting detailed designs and associated timings.

Section 3 – Timely Delivery

4. As compared with commercial liquidated damages, how effective are options 1 and 2 in incentivising timely delivery and managing the risk of delay? Could these options make OFTO build a meaningful option for the generators?
5. How can the OFTO delay charge and consumer underwriting in option 1, as well as the TRS reduction in option 2, be appropriately set and executed?

NGV recognises on-time delivery as a central aspect of the OFTO build model, from an OFTO's perspective this is critical as energisation commences the TRS – a mechanism which alone may suitably incentivise on-time delivery from an OFTO's perspective.

NGV's view is that a standardised approach to liquidated damages as opposed to negotiated liquidated damages will be most appropriate in achieving desired objectives; however as noted within the consultation, there will be limitations on the level of liquidated damages an OFTO can absorb before undue pressure is placed on TRS and consequential impacts occur in relation to their finance-ability. Of the options presented, option 1B helps to reduce OFTO risk more so than option 1A by including a level of consumer liability, but consideration must be given to this formula to ensure best value for consumers is achieved. That said, as both options 1A and 1B require the OFTO to hold risk-bearing capital, both are less efficient than option 2 because of the associated costs of holding such capital.

Of the options presented, option 2 is expected to be the most appropriate mechanism to achieve stated OFTO build objectives, providing it is carefully calibrated to ensure it acts to incentivise successful, on-time completion without making OFTO build opportunities unduly less attractive to potential OFTO investors. Unless calibrated appropriately, a risk premium could be incurred from bidders under the threat of punitive liquidated damages or worse, participation could be discouraged entirely thus reducing market liquidity. OFTOs would typically seek to reflect liabilities in their supply-chain contracts and as such, setting them to a punitive level would also reduce project attractiveness to prospective suppliers.

Irrespective of the options laid out in this section, should the procurement be generator- rather than OFTO-led then the eventual OFTO should not be exposed to delay damages if the delays can be attributed to the actions and decisions of the generator(s) before an OFTO contract has been awarded. Exposing an OFTO to delay damages in this way would increase complexity and risk to the OFTO, thus requiring further guarantees to be in-place when taking over any detailed designs and contracts, and potentially increasing bid prices to factor in the increased risk. The above carries across onto the below section also, in relation to allocation of cost increases during construction.

Q4 – Cost Increases During Construction

6. Which of the four proposals offers the most suitable option for the treatment of cost increases during construction?
7. What, in your view, is an appropriate calibration for the pain-gain share mechanism outlined in options 3 and 4?

Option 1 is an established and generally accepted mechanism, as is used frequently within transmission networks – such as within interconnection – and as such is NGV's preferred option. In contrast, option 2 could be considered punitive as the minimum threshold to meet before cost increases can be re-opened could entirely diminish the OFTO's TRS, reducing the viability of OFTOs or leading prospective OFTOs to increase bid submissions accordingly to cover the associated risk.

Of the two 'pain-gain' options available, option 4 is more acceptable than option 3 from NGV's perspective as it provides coverage (in the form of a cap) over the extent to which an OFTO bears the risk for cost increases. That said, the cap must be set to an appropriate level and allocation of cost increases must account for the dynamics of the parties involved in the OFTO build model. Depending on the number of generation assets connecting onto an OFTO's transmission cable, the proportion of risk should be reduced for the OFTO in line with more generation assets being added, to ensure the individual generators are still liable for a proportional percentage of the risk. NGV's view however is that option 4 provides a greater risk than option 1 of rendering a project financially unviable, owing to the need for certain costs to be absorbed by the eventual OFTO. If option 3 or 4 are pursued, then arrangements should be implemented to provide coverage for events outside of an OFTO's reasonable control which could not have been economically and efficiently planned for but have a material impact the OFTO's costs, to ensure OFTOs are not expected to absorb unforeseeable costs.

Q5 – Refinancing Gain Share

8. Should we expand the refinancing gain share mechanism to cover the conversion of equity to debt or the sale of equity? How could the mechanism work in principle?

NGV's view on this topic is that, if established, the sharing mechanism must be sufficiently compelling to effectively incentivise the OFTO to refinance; if the sharing mechanism fails to accurately reflect the risk taken through construction of the OFTO asset and the effort of refinancing with an appropriate reward, then the OFTO is unlikely to choose to refinance. Ofgem should also recognise that OFTO bid submissions may make assumptions in relation to respective financing approaches, for example a decrease in financing costs between construction and operation phases owing to refinancing post-construction, which from the outset may be factored into the TRS levels. In this example, once the OFTO comes to refinance post-construction, savings may already have been anticipatorily reflected in an OFTO's TRS and as such should not be shared with consumers. This consideration is specific to the OFTO build model, as unlike the existing OFTO regime there are two distinct project phases – construction and operation – which could lead prospective OFTOs to make financing assumptions accordingly.

Q6 – OFTO Failure During Construction

9. What do you think is the best way to deal with a failure scenario during construction?
10. In the event that the appointed OFTO cannot continue with the project, which party is best placed to take the build to completion? How should the transfer value for a partially completed project be set?

NGV recognises that failure during construction would cause a negative outcome for all parties involved and could reduce confidence in the OFTO build regime. A regime which requires high levels of debt in order to achieve an attractive rate of return and still be competitive may not be a sustainable model should underpinning financial market conditions change. For this reason, the tender process should consider the longevity, sustainability and financial robustness of prospective OFTOs and their funding structures, including under changes to market conditions and financial stress events, to help ensure a bidder's ability to continue to construct, maintain and operate the asset for the entirety of its in-service period. Suitable up-front due diligence, tender design and tender evaluation should serve to minimise the risk of OFTO failure, widening the attractiveness of the regime to capable bidders.

We welcome the additional detail provided on the OFTO Of Last Resort (OLR) approach included in the consultation and are pleased to see that this mechanism is only expected to be used after other regulatory and statutory options have been exhausted. Taking on a project unexpectedly will have an impact on the delivery of the project in question, as well as the other project(s) of the appointed OFTO OLR. We would welcome confirmation from Ofgem that the terms on which a project would be transferred would be agreed by Ofgem and the OFTO OLR ahead of transfer, and that these will be adapted as necessary to reflect the risk profile of the project and the delivery ambition, with the implication that additional TRS arrangements and/or allowances would be required to enable successful delivery. While the consultation provides some additional detail, we would appreciate further clarity on whether it will be mandatory for existing OFTOs or TOs to take on projects in certain circumstances, the route to obtain funding to deliver projects, how this would be achieved under existing licence frameworks, as well as how the associated risks – and associated implications for returns/revenue streams – would be considered.

If an OFTO fails within delivery, NGV's view is that the transfer value should be set by an independent auditor to ensure that any assessment is both robust and impartial. The independent auditor should conduct an assessment based on works in-progress and completed pre-failure in order to set an appropriate transfer value thereafter, with any costs borne in conducting this assessment to be incurred by the failed OFTO to ensure consumers are not indirectly paying for OFTO failure. Equally, it is important that any process to appoint an OFTO OLR reflects where the project is in terms of development – i.e. operational versus in construction versus pre-construction – as well as the project's risk profile. For example, failure of an OFTO before construction could indicate a project that is more difficult to deliver, with the implication that additional allowances or revenue would be required to enable successful delivery.