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Dear Team

INITIAL PROPOSALS FOR AN OFTO BUILD MODEL TO DELIVER NON-RADIAL OFFSHORE TRANSMISSION ASSETS

Thank you for the opportunity to respond to this consultation. This response is submitted on behalf of ScottishPower Renewables (SPR).

SPR is a leading developer of renewable energy generation, with over 3.1 GW of operational wind capacity across over 40 sites using onshore wind, offshore wind, solar and battery technologies. SPR has ambitious plans to expand its existing onshore wind portfolio and to invest in large scale solar deployment and innovative grid storage systems including batteries. Building on our 714 MW East Anglia ONE offshore wind project, we have work underway to take forward offshore wind projects comprising an East Anglia Hub, as well as seabed rights to develop three new offshore windfarms off the coast of Scotland with a total capacity of 7 GW as part of The Crown Estate Scotland's ScotWind Leasing. ScottishPower is fully supportive of the UK's ambitious but deliverable onshore and offshore targets for 2030 and 2050, which are pivotal in delivering upon the Government's decarbonisation ambitions.

Our answers to the consultation questions are in Annex 1 attached. We would highlight the following points.

<u>Balance of risk and responsibilities within an OFTO build model for shared connections</u>

The successful delivery of shared non-radial offshore transmission connections via an OFTO build model relies on the optimal allocation of risk and responsibilities between the various wind developers with an interest in the connection and, most importantly, between the "lead" developer and the OFTO. Ideally, we would prefer an *early* competition OFTO build model, where maximum value could be delivered by having a single party (the OFTO) managing and optimising design, procurement, and construction in combination. However, in the context of a *late* competition OFTO build model (the focus of this consultation), we think procurement is best assigned to the OFTO, leaving design as the responsibility of the lead developer. We think in practice the level of

uncertainty ahead of securing planning consent will limit any additional value the lead developer could deliver from engaging supply chains in advance.

For similar reasons, we believe the OFTO tender can realistically only begin *following* grant of planning consent. Notwithstanding our preference above for OFTO-led procurement, if the lead developer is to take responsibility for design *and* procurement, subject to relevant technical and regulatory approvals, it is essential the OFTO accepts the design and procurement arrangements and shares any associated risk with the lead developer and other developers connecting. Without such an arrangement, the lead developer will face undue risk which it may not be feasible to manage, and this would significantly blunt any incentives to adopt an OFTO build model. This approach is consistent with Ofgem's proposals in this consultation regarding the sharing of construction risk.

Regulatory gaps for shared offshore transmission connections

In previous consultations on coordinated offshore transmission connections we have commented on the impact of the absence of a regulatory framework to support relevant developers in delivering the connection. Despite the coordinated offshore transmission solution now being identified through the ESO's holistic network design (HND), there is no framework to support how the developers concerned agree the model for delivering the shared transmission assets and key questions such as which party should act as lead developer. This consultation assumes developers have agreed on an OFTO build approach and who is the lead developer; however at present we don't believe this is straightforward. Given the Government's offshore wind targets, it is important that developers involved in shared offshore transmission connections can agree and deliver the offshore transmission assets in a timely manner. To this end, we believe Ofgem and Government should address this regulatory gap as a matter of priority, for example giving the ESO additional functions and responsibilities in the design of its identified non-radial connections and creating a process for adjudicating issues such as designation of the "lead" developer etc.

OFTO construction delivery incentives and sharing of risk with developers

Ofgem notes that developer(s) should absorb some of the construction risk with OFTOs under an OFTO build model. Accordingly the options proposed only seek to partially compensate developer(s) for financial loss arising from delays to construction by the OFTOs. In this context it will be important for Ofgem to demonstrate that any option will provide an effective incentive on OFTOs to achieve timely delivery of the offshore connection and represent a fair share of construction risk with developers. Failure to do so will mean that developers are less confident in adopting the OFTO build model for non-radial connections. In principle we would support the proposed option 1 (standard compensation set in advance by Ofgem) but we require further information to adequately evaluate the options, specifically the amount or level of compensation the developer would receive and the expected effectiveness of the resultant construction delivery incentive on the OFTO, and the basis of calculation for both aspects.

If you wish to discuss any aspect of our response, please do not hesitate to contact me or my colleagues Haren Thillainathan (hthillainathan@scottishpower.com) or Deborah MacPherson deborah.macpherson@scottishpower.com)

Yours sincerely,

Richard Sweet
Director of Regulatory Policy

Annex 1

INITIAL PROPOSALS FOR AN OFTO BUILD MODEL TO DELIVER NON-RADIAL OFFSHORE TRANSMISSION ASSETS – SCOTTISHPOWER RESPONSE

Chapter 2: Procurement under a late competition OFTO Build

Q1. Which party should be responsible for procurement in the late competition OFTO build model and why?

Our preferred option in general for non-radial connections is that the OFTO takes on responsibility for the design as well as procurement and construction of the OFTO assets in an early competition model. However, in the case of the late competition OFTO build model, where the developer[1] (or one of the developers) is responsible for design and the OFTO is responsible for construction, Ofgem notes that procurement could either be the responsibility of the OFTO ('Option 1') or the developer ('Option 2'). Ofgem's initial preference is for Option 2 given current supply chain constraints and the ability of developers to engage earlier with the supply chain than OFTOs.

We disagree with Ofgem's initial view that the lead developer would be able to deliver material additional value by conducting earlier engagement the supply chains versus the OFTO undertaking procurement. Relative to radial connections, non-radial connections will be bigger and more complex, involving more parties, and therefore in practice there will be a great deal of uncertainty regarding the connection design ahead of planning consent being obtained. In this context it will be difficult for the lead developer(s), let alone another party, to conduct effective supply chain engagement ahead of planning consent, and for the same reason (see our response to Question 2) we think the OFTO tender process should commence after planning consent. In this context we think there is greater value in the OFTO taking responsibility for procurement ('Option 1') and optimising its approach in combination with construction.

We believe that the procurement process could still be managed effectively by the OFTO if initiated in a timely manner by requiring interested OFTO bidders to conduct pre-tender procurement engagement against the confirmed connection design following grant of planning consent. We recognise this approach will result in additional tender costs from multiple OFTO bidders undertaking pre-tender procurement engagement, but we think this is a reasonable trade-off and will deliver more value than just one party (the lead developer) undertaking the exercise. If this approach is followed, OFTO bidders would need to initiate the procurement process prior to the invitation to tender (ITT) phase of the tender to assess the costs involved in constructing the OFTO assets, based on the design provided at that time. For this timeline we think the lead developer would be required to provide the final design approximately 3 months after the granting of consent.

Due to the current constrained global supply chain, the timescale allocated between first contact with supply chains and commissioning of the transmission assets should be approximately 3-4 years for HVAC systems and 7-10 years for HVDC systems, in order to secure fabrication slots. Ofgem should consider the timeline of the tender and construction to account for the supply chain constraints, ensuring sufficient time is allocated in advance of construction by the OFTO.

[1] Although the consultation refers to "generator" we use the term "developer" to mean the same entity and be consistent with our previous responses.

We would expect Ofgem to ensure that in an OFTO-led procurement strategy, successful bidders can demonstrate sufficient track performance in similar procurement exercises, to ensure the timely, economic, and efficient delivery of the OFTO assets.

If the lead developer does assume responsibility for procurement ('Option 2'), it is essential that, subject to conducting due diligence during the tender process, the preferred OFTO bidder formally accepts the procurement arrangements and shares any associated risks during construction. In practice this would mean the preferred OFTO bidder would not be allowed to request additional liabilities or contingencies from the lead developer in relation to the established procurement arrangements on the basis all bidders would have had the opportunity to do their due diligence on the procurement arrangements as part of the OFTO tender process. Without this condition, lead developers would face undue commercial risk, reducing incentives to assume the relevant roles and responsibilities. We have previously highlighted the lack of a framework governing how developers on shared connections should coordinate to deliver the transmission assets, including the designation of the lead developer. Any imbalance of risk around responsibility for procurement could exacerbate this and threaten the timely delivery of non-radial connections.

Chapter 3: Tender process

Q2. At what point should the OFTO tender process commence? Does option 1 or option 2 present the best approach?

The OFTO tender process for non-radial connections using the OFTO build model should commence at a stage where the design and/or procurement of the assets are sufficiently detailed to allow OFTOs to submit accurate bids during the tender exercise. Out of the two options offered, commencing the OFTO tender at consent grant ('Option 1') represents the better approach as it would be the only viable option to ensure sufficient details regarding the connection design can be provided by the developers involved to support a robust tender. As noted in our response to Question 1, grant of planning consent is also the first point at which procurement engagement of supply chains can be done with any reasonable confidence. In this context, we think there is little additional value the lead developer can deliver from earlier procurement engagement, and in fact there is more to be gained by the OFTO undertaking procurement and optimising it with its construction strategy. We suggest the lead developer provides the finalised non-radial connection design around 3 months after obtaining planning consent, enabling potential OFTO bidders to undertake pre-tender procurement engagement to inform their bids at the invitation to tender (ITT) stage.

A tender process commencing at consent submission ('Option 2') would likely involve significant expenditure by the lead developer before it has secured a route to market (eg CfD) and reached Final Investment Decision (FID). (This expenditure would be associated with ensuring the design is finalised with limited variation, prior to the OFTO ITT.) These impacts would be greater in a multi-contract approach, imposing significant time and costs for developers to agree consequential variations with their contractors.

Holding the tender exercise prior to consent grant may also increase the financial exposure for OFTO bidders who would incur upfront costs (admin, legal etc) in assessing the project prior to confirmation that the project is viable.

The consenting process can result in the granting of consent but with additional conditions imposed upon the developer. During the process, in certain locations within the UK, there may be increased challenge from external stakeholders in response to the consent application. Dealing with such additional conditions can take time and may even result in the project becoming unviable due to the cost of the solutions required. In any case, there is a risk that

this increases the timeline of the consent process, providing further reason why the tender process should follow the granting of consent.

Q3. Do you agree with the view that, providing stakeholder engagement is properly conducted ahead of consent submission, developers 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?

We do not believe it is possible to have a clear view whether the consent is likely to be granted or not upon submission of the application. The consenting process, particularly for non-radial assets, is complex relative to radial connections and it is difficult to predict the responses from the engaged stakeholders during the process.

It would be difficult for the prospective OFTOs to accurately submit bids in advance of the granting of consent as the final design and costs resulting from the consenting process would be difficult to fully anticipate. If the tender commenced prior to consent bring granted, additional conditions may be imposed upon the developer which could result in changes mid-tender, hence extending the time of the tender process. There is an additional challenge that OFTOs may not be interested in participating in a tender until such point that the project has been granted consent so as not to incur costs prior to the project FID. This point should be explored directly with prospective OFTOs.

Chapter 4: Timely Delivery

Q4. As compared with commercial liquidated damages, how effective are options 1 (Standardised compensation set by Ofgem in advance) and 2 (Phased progressive TRS reduction) in incentivising timely delivery and managing the risk of delay? Could these options make OFTO build a meaningful option for the developers?

The options proposed aim to provide compensation to the developer in the case of a delay during construction, but not to the full value of the developer's loss. It is not clear that either of the options proposed represents an effective incentive on timely delivery of the non-radial connection by the OFTO. Furthermore if developers are expected to absorb some of the loss arising from a delay to construction, it should be clear that this is an appropriate sharing of construction risk. Ofgem must be able to demonstrate both these points for developers to have confidence in the OFTO build model.

A delay to the construction of the OFTO assets has the potential to delay the Target Commissioning Dates set for the developer during the CfD process. If the delay exceeds the 12-month window and the project has yet to be commissioned, the developer's scheduled revenue stream (CfD payments) starts to erode. If delays exceed 24 months, there is a risk that the developer loses the CfD completely and is not then allowed to enter subsequent auction rounds for two years. There is also a risk that the developer misses the connection date to which it is engaged with the ESO through the Bilateral Connection Agreement and therefore face delay charge.

Option 1 (standardised compensation set by Ofgem in advance)

Ofgem notes that for Option 1 (standardised compensation set by Ofgem in advance), the partial compensation *may* be linked to the developer's loss of revenue, but that it may be restricted so as not to impair the OFTO's financeability. The prospect of receiving only partial compensation may undermine the attractiveness of this model to the developer. Ofgem should

confirm the metrics that would be taken into consideration for this option (eg the windfarm capacity, wind yield if the windfarm was to be operational). Scenario B of Option 1 is more realistic than scenario A since, depending on the delay length, the compensation recoverable by the OFTO from means such as subcontractor liquidated damages and insurance may fall well short of the overall loss due to delays, meaning that an additional consumer contribution would be needed to underwrite the remainder of the delay loss.

Option 2 (Phased progressive TRS reduction)

Option 2 (phased progressive TRS reduction) would result in reduced TNUoS payments by the developer, however, impacts to the programme would result in a greater loss to the developer than the benefit of reduced TNUoS payments. Additionally, the developer(s) would have to wait many years to receive this compensation, creating cash flow risks over that time.

In the case of a developer build model, the most common mechanism to deal with programme delays is to instruct the contractors to recover the delay in line with the programme or to action liquidated damages as per their contract (often capped at approximately 10-15% of contract value). It would be helpful if Ofgem could demonstrate how Options 1 and 2 would compare to this both in terms of incentivising timely delivery by the OFTO and level of construction risk assumed by developers.

Q5. 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?

The OFTO delay charges payable to the developer should be set considering the CfD, LCoE (Levelized Cost of Electricity), wind yield parameters and any other metrics relevant to the project.

Our response to Question 4 noted that the financial consequences of delays are likely to be far greater for the developer than for the OFTO (in terms of availability penalties). The largest risk to the developer is that the target commissioning window is missed and the CfD is eroded or revoked. Ofgem should ensure a fair compensation mechanism is adopted. The consultation refers to a system where the OFTO would be compensated in cases where the developer is late. Ofgem should provide clarity on what this is in reference to, e.g. agreed milestones. As noted in our response to question 4 a useful comparator are standard industry liquidated damages.

The impact of force majeure events should also be considered. Construction delays may be deemed by the OFTO to be due to a reason outside their control, adversely affecting the developer's project. This should be subject to assessment by Ofgem, and a clear definition of a force majeure event should be provided. Ofgem should also consider on what basis any additional costs resulting from a force majeure event would be shared between the OFTO and the developer.

Chapter 5: Cost Increases During Construction

Q6. Which of the four proposals offers the most suitable option for the treatment of cost increases during construction?

Ofgem has proposed four options the treatment of cost increases during construction:

- Option 1 – Post construction cost assessment
- Option 2 – Post construction cost assessment with materiality threshold

- Option 3 – Uncapped ‘pain-gain’ share mechanism
- Option 4 – Capped ‘pain-gain’ share mechanism

Of the options proposed by Ofgem, our preliminary view is that Option 3 may be the most viable.

As a general principle we would prefer options that do not seek to increase the original tender revenue stream (TRS) for any cost increases. Rather, we would favour options that involve assessments of cost increases outside the TRS and are subject to a “pain/gain” sharing mechanism. As the developers will benefit from the shared OFTO asset, some form of pain-gain share would be acceptable, however the metrics to define the allocation should be clear.

Irrespective of which option(s) are considered viable for developers, all options should involve a cost assessment by Ofgem. Options 1 and 2 would impact the TRS, in turn affecting the developer TNUoS charges which would not be an attractive option for SPR.

Q7. What, in your view, is an appropriate calibration for the pain-gain share mechanism outlined in options 3 and 4?

The cost increases during construction should be subject to an assessment of economic and efficient costs by Ofgem. The OFTO should have taken appropriate risk mitigation measures during the procurement and construction phase so that it is able to absorb most of the costs incurred through its agreements with its contractors. Developers involved in the non-radial connection should contribute towards the increased cost incurred (likely based on their capacity), but most of the cost increase should be absorbed by the OFTO responsible for the construction of the OFTO assets.

Chapter 6: Refinancing Gain Share

Q8. 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?

We believe OFTOs will be better placed to answer this question. However, Ofgem will need to balance the benefits of sharing the gain with the consumers and the risk of discouraging OFTOs from investing into the regime.

Chapter 7: OFTO build failure during construction (OFTO of Last Resort)

Q9. What do you think is the best way to deal with a failure scenario during construction?

We see this failure scenario as being very unlikely given that we would expect Ofgem to undertake a rigorous qualification process to ensure that an appointed OFTO is able to complete construction and continue into operation in all circumstances.

In the event that an OFTO was unable to build the OFTO assets to completion, we believe that an independent entity such as an Energy Administrator should be able to take over the assets initially to make a fair assessment of the progress made and the value of the assets. The developers would support Ofgem and the administrator with such transition.

Ofgem should then carry out a cost assessment to determine a transfer value and conduct a further tender to appoint a new OFTO to complete the construction. Contractually, we believe

this is a cleaner option than engaging a developer who would then be required to divest the assets again.

Ofgem notes that an OFTO of Last Resort (OLR) would only be appointed should Ofgem's attempts to appoint an OFTO using other regulatory and statutory options fail. These other options include:

- **Enforcement** – where Ofgem monitors the OFTO licensee to ensure it abides by its licence conditions, issuing enforcement orders or imposing financial penalties as appropriate.

- **Open market sale/transfer of the assets by the OFTO** – where the OFTO cannot resolve the operational or financial issues, it may sell the assets to a party who is able to resolve the issues and recover the assets. Section 7A of the Electricity Act notes that the OFTO must obtain consent from the Authority to transfer the licence and may be subject to conditions imposed by the Authority.

- **Energy Administration** – deemed to be the primary mechanism for dealing with most financial issues that an OFTO may face. The Energy Administrator would operate the assets with the objective that the system continues to be maintained economically, as developed, until such point as it is not necessary to be in force. The administrator would seek the best value of the assets and may request to run the OLR process, sometimes the only viable option to ensure continued transmission. The OLR process allows a transmission licence to be granted for a term of up to five years, which can be extended upon the initial expiry.

- **Re-tender exercise** – there is a substantial risk with this option that the completion of the construction of the OFTO assets would be delayed due to the timescales of the re-tender. The result is that the developer may risk losing its CfD target commissioning window, economic stability, and revenue due to delayed generation. There is also a risk that OFTOs are not interested in taking on the partially constructed assets, leaving the developer assets stranded. There is an option that one of the developers could take control of the project and complete the construction of the transmission assets. However, the risk then lies with the developer in inheriting the failed project and the subsequent difficulties in rectifying the situation while ensuring costs are economic and efficient. The result is a switch to a developer build model whereby a subsequent tender would ensue to appoint another OFTO after completion of the construction of the OFTO assets by the developer.

In a failure scenario, the above options are potential solutions, however any party taking on the partially constructed assets will be cautious in their estimate of costs to rectify the situation. The incumbent OFTO will have incurred costs in taking the project and construction to a certain point and the party taking over should not being bound to those previous cost allowances. Ofgem should assess those costs, and those which are deemed to be economic and efficient should form the transfer value.

It might be assumed that the lead developer would be in a good position to take over the completion of the construction of the assets, given that it would have been involved during the initial design process. However, any party taking this on would need to secure the capital required to complete the project as well as inheriting of the risks involved in an unfinished construction asset, which the developer will rely on to secure their revenue stream.

Q10. If 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?

We believe that an alternative OFTO would be best placed to take the build to completion especially one with a prior track of delivering construction of offshore transmission assets. However initially an independent entity such as an Energy Administrator could take over to assess the project prior to a re-tender to another OFTO.

If the incumbent OFTO is unable to take the project to completion, there is a risk that another OFTO will experience similar difficulties in completing construction of the OFTO assets. Ofgem would need to consider the reasons for the failure during construction of the incumbent OFTO to better understand how to prevent similar failures in the future.

The transfer value for a partially completed project should consider the contracts made to date and the progress of the construction but also consider the fact the project is being inherited partly completed. The failing OFTO would be expected to provide cost assessments of the inputs to the project to date. Ofgem should then assess the costs and those which are deemed to be economic and efficient should form the transfer value.

As explained in our response to Question 9, the lead developer or other developers on the connection would not be in a position to assume construction of failed OFTO's assets.

ScottishPower
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