

Richard Clay
Senior Manager, Offshore Transmission
Ofgem
9, Millbank
London
SW1P 3GE

Iain Cameron
Head of Business Development
Europe

Iain.Cameron@uk.ngrid.com
Direct tel +44 (0)1926 654089
Direct fax +44 (0)1926 653102

www.nationalgrid.com

14 November 2008
Our Reference NG/IC

Dear Richard,

Offshore Electricity Transmission – Competitive Tender Process 142/08

This response is from National Grid in respect of our interest as a potential investor in offshore transmission networks. It has been prepared by a National Grid business development team who are separate from National Grid Electricity Transmission (NGET) activities relating to offshore transmission (i.e. both GBSO and onshore TO).

In our view, the need for certainty and clarity in the details of the regime and the tender process is becoming increasingly important and urgent for the following reasons:

- the target date for Go Active and the first tender round commencing is approaching rapidly and delay will further put the 2020 target at risk and increase delivery cost
- the Round 3 process is under way and developers need to make critical decisions by Q1 2009
- the supply chain is becoming more constrained as UK workload increases and other worldwide markets develop rapidly
- the liquidity squeeze in the financial markets since September has led to sharper focus on risks and uncertainties in the process of obtaining project finance.

We had expected the consultation document to clarify many of our outstanding concerns regarding the tender process as a central part of the proposed regime for offshore transmission and it is clear that significant progress has been made. We are, however, disappointed that significant areas of uncertainty and lack of detail still exist, which we have outlined below. Our principal concerns are:

- For projects where a “generator affiliated OFTO” is bidding there may not be a level playing field for non affiliated, independent OFTOs
- Despite the long elapsed time for the tender process there is still no clarity on how EU utility contract regulation compliant procurement processes can be applied within the time constraints of the tender process
- The rights of the selected OFTO during the construction stage of a Transitional Project are not clear

- Following publication of the document, there is evidence of developers reducing the level of engagement and discussion of innovative solutions with prospective OFTOs for fear of contravening the tender process. The rules of engagement must be made clear
- The variant bid concept only applies within one tender window, which will lead to missed opportunities for optimising transmission solutions between projects.

The longer these matters remain unresolved the more we are concerned that the tender process may not be developed to a sufficient level of detail by April 2009 to enable companies independent of generation, such as National Grid, to invest in offshore transmission network infrastructure.

The suitability of the tender processes described in Chapters 4 to 6 of the consultation is dependent on the extent to which they will encourage the development of suitable transmission solutions and then provide the information needed in order to select the best in accordance with the regime objectives. While Chapter 3 makes reference to issues and further policy developments, the consultation document does not explicitly set out the tender objectives. In the absence of such objectives, the need to successfully deliver the following key regime features is highlighted:

- 1) Delivering effective OFTO appointment competition (in both the transitional and enduring regimes).
- 2) Achieving co-ordination of network development.

This response presents some observations on these challenges and then addresses the questions posed concerning the material in Chapters 4 to 6 in the consultation document.

OFTO appointment competition

The extent to which any benefits of this regime will be passed to consumers depends on an appropriate regulatory valuation of the assets by Ofgem and on effective competition between potential OFTOs to determine an efficient cost of financing those assets. In terms of valuing the assets, the consultation mentions the valuation process (Chapter 5) but provides few details on how it will be undertaken or how it might affect potential bidders.

In terms of the OFTO competition, there is a key issue that will affect the scope for competition between independent OFTOs and an OFTO established as an affiliate of the generator developer/operator. Compared to the availability/performance incentives so far proposed for the offshore regulatory regime, the OFTO in an affiliated group will have stronger and better aligned incentives to its generation affiliate to operate/repair network assets in a manner that best protects the group's value. This means an OFTO affiliated to a generator group will bid a discount to other OFTOs in order to retain this value. The option proposed by Ofgem to undertake regular price controls in the event of insufficient competition does not mitigate this issue and might inadvertently reinforce it.

On this basis, independent OFTOs will need to be very wary of incurring large bid costs to participate in a competition that is biased against them. As currently formulated, the tender is unlikely to encourage significant competition to affiliated OFTOs.

Design co-ordination

A key factor identified in the decision to adopt the proposed regime over the merchant development alternative was the ability to co-ordinate network development so that future connections would not be hindered by measures bringing benefits only to present developments. However, neither this consultation document nor previous policy documents identifies how design co-ordination will be incorporated into the tendering process.

We understand that Round 2 connections through environmentally constrained areas are being proposed and this may have significant implications for future (Round 3) connections.

The EU Commission is proposing a new EU Energy Security and Solidarity Action Plan which considers a North Sea Offshore Grid. Further clarification is required on how the design of this Offshore Grid will be developed within the proposed Offshore Transmission regime.

To address these co-ordination issues, a network design authority should be established with objectives aimed at ensuring individual development steps are not to the detriment of longer term development goals. Such an authority would benefit from representation across the industry.

Comments related to specific points in the consultation are made in Annex 1.

Yours sincerely,

Iain Cameron

Cc: Christian Stevens

Annex 1

Comments relating to Offshore Electricity Transmission: Competitive Tender Process Ref 142/08

4.15 requires compliance with industry codes and technical standards. Technical standards are well established for onshore transmission but they are not set for offshore substations. As a result potential OFTOs will have to price in the risk of the impact of the future standards into their bids.

4.24 makes reference to the Ofgem tender panel. We request that Ofgem disclose the make up of panel as soon as possible.

4.37 requires the prospective OFTOs to accept the developer's terms of transfer, without amendment, for the project. Further guidance is required on the following points:

- What the transfer terms will be and any limits on what the developer can and can not specify in their terms of transfer
- Whether the developer can specify special conditions or influence over OFTO O&M, insurance or financing and whether any such special conditions would be disclosed at PQQ stage to avoid surprises and unnecessary bid costs on the part of the prospective OFTO
- The rights that a successful OFTO would have during design and construction of a project that was under or yet to start construction.
- How the dispute process would work if the OFTO's engineer is of the opinion that the developer had failed to properly install the asset leaving an unacceptable risk of cable or equipment failure and whether the OFTO would have the right of withdrawal or whether the developer's terms of transfer would prohibit this.

4.43 refers to the required electricity transmission services.

- Further explanation is required on what is meant by this as in the absence of long term industry experience and design standards, prospective OFTOs will bid different O&M regimes costing different amounts and providing a varying degree of assurance of asset integrity.
- Further clarification is required as to how Ofgem will judge, and rate in importance between price and quality, the difference in O&M programs between prospective OFTOs.

4.45 states that the bidder must provide a declaration that it accepts the generator's performance requirements. Clarification is required regarding how this relates to the 10% revenue risk for 98% of availability rule.

4.54 refers to the variant bid. Although the ability to raise a variant bid for a group of projects is a welcome addition to the regime it is constrained by other elements of the consultation.

- In a transitional bid situation should an OFTO be successful in obtaining the projects in one geography with a variant bid, that OFTO would have a sizeable advantage in 2010 bidding their economy of scale benefits in the same geography. In 2010 prospective OFTOs may not believe they can compete and the lack of competition rules could apply.
- In the enduring regime an OFTO may wish to bid a shared infrastructure transmission design that provides additional security of supply to the developers, reduces complexity to the onshore TO, leaves more options open for cheaper round three connections and requires fewer cables buried in the seabed and beaches. The developers will probably bring the projects required for the full shared infrastructure design in different tender windows. The regime currently prescribes a bidding strategy in the first year of the 'infrastructure OFTO' bidding a cheaper radial AC price but specifying the first stage of a more expensive HVDC solution, thus making a loss on the first part of the project. In the second year OFTOs will bid against the 'infrastructure OFTO' for the second project required for the original overall transmission design. This second bid will raise the following concerns;
 - Competition rules could be invoked if other OFTOs believe that they cannot bid against the infrastructure OFTO

- Lack of competition rules could be invoked as other prospective OFTO's may not believe they can compete
- The original efficient design may not be completed with projects from further tender rounds as other OFTOs may bid cheaper AC connections to the shared infrastructure.
- Management of competition issues if the use of infrastructure OFTO's assets are included in the bid for the second project. Clarification will be required on the rights of the OFTO to refuse access to other OFTOs.
- Clarification is required on the rights of the GBSO to refuse connections resulting in inefficient network designs from a holistic perspective.
- The efficient management of grid connection costs between the infrastructure OFTO and the second project wind developer.
- The PQQ specifies on page 2 point iv states that "any applicant who in connection with a particular project contacts the developer prior to the selection of bidders for the project about any aspect of the project in a manner not permitted by the prequalification document will be disqualified". This reference is already preventing prospective OFTOs from discussing the possibility of a shared infrastructure design with different developers in the same geographic region. The rules are actively preventing the innovation in design that the consultation champions.

4.70 refers to the independent engineering audit. We request that the terms of reference of this report be published as soon as possible.

Chapter 5 discusses the pre tender requirements. Further explanation is required regarding how Ofgem will carry out the RAV assessment.

6.10 does not contain any information about the expected timescale of the bid.

6.18 as with the transitional regime we request that Ofgem describe the terms of reference of the independent engineering audit as soon as possible.

6.33 refers to the seabed survey and that either the developer or bidders should cooperate to undertake the surveys.

- Under the current regime it is difficult for the OFTOs to have an input into the seabed survey. Under the PQQ disqualification rule mentioned in the chapter 4 section, developers are cautious about discussing projects with prospective OFTOs before the tender window opens. Also prospective OFTOs are unlikely to commit to a seabed survey cost until they have passed the PQQ stage and there is a commitment to the tender.
- Developers will be encouraged to conduct a seabed survey for the point to point radial connection. This could become a wasted cost and a barrier to a shared infrastructure design.

Comments relating to Annex 2- Draft Template Prequalification Document Ref 142/08a

Section D4 requires staffing details of how the applicant and associated sub contractors will deliver the transmission services. Prospective OFTOs will be new subsidiaries of existing companies or a special bid vehicle drawing on resources of partners or a start up business. Staffing would be committed to the OFTO company on winning one or more bids and are likely to have few employees at the PQQ stage.

1.4.4 and section 6.3 in the main consultation document. This section states that "the Preferred Bidder must demonstrate to Ofgem that it has the necessary land agreements, both onshore and offshore". Please clarify how this statement is consistent with statement 5.6b in the main consultation document which states that "the offshore developer has obtained all necessary property rights and environmental and planning consents for the offshore project".

Comments relating to Annex 2 - Draft Template Invitation to Tender Document Ref 142/08b

2.4 This section should refer to EU Directive 2004/17/EC (coordinating the procurement procedures of entities operating in the water, energy, transport and postal services sectors) and the related UK Utilities Contracts Regulations 2006.