

Introduction and Summary

SP Energy Networks (SPEN) welcomes the opportunity to comment on the issues raised in this consultation.

SPEN is a key participant in the offshore electricity transmission ownership debate, with a proven track record in delivering major infrastructure projects as well as operating and maintaining transmission networks. To date, we have viewed the process of developing the regulatory regime and associated codes as an important strategic development with potential benefits for all parties involved in delivering offshore wind. However we are very concerned that the latest consultation fails to advance some of the areas over which we have significant concerns.

Although the regime has been cited by Ofgem as a low risk investment opportunity, characteristic of a price controlled regime, from SPEN's perspective the proposed regulatory framework is a fundamental departure from existing price control mechanisms, which are well understood by investors.

The current arrangements and proposed structure of 'incentives' presents an asymmetry of risk increasing the exposure of the OFTO, this is incompatible with simultaneously suggesting returns should be low, perhaps even consistent with existing allowed rates of return.

We have highlighted to Ofgem the nature of our concerns and also underlined that the experts we have spoken to, including insurers, developers and those among the legal community, share this view.

While our concerns relate, in the main, to the actual form of the proposals, we are also concerned by the lack of detail at this late stage. There are a number of issues that are still to be clarified in the next joint consultation, with no suggested date of when that will be published.

Examples of key areas where details are currently lacking detail, require modification or where risks appear to be unduly tilted towards OFTOs include the following:

- Reopeners - "Unknown unknowns" – other than a general reference to the Authority's statutory duties, the paper gives no indication what criteria will be used for re-opening the price control; this is not appropriate for a regime challenging environment of offshore transmission. Unpredictable events that cannot be insured effectively should trigger a re-opener.
- Reopeners – "Known unknowns" – are an essential element of assessing risk and the proposal should be finalized as a matter of urgency. Insurance premiums must be categorised as 'known unknowns'
- Operational incentive - arrangements affecting up to 10% of annual revenue remain unclear. Again, we await a further clarification. A standard availability target is impractical and unrealistic and incentives should be negotiated on a project-by-project basis.

For the regime to attract participants and it must be clear, fair, offer a balanced risk profile and provide sufficient certainty to attract efficient investment. The regime in its current form does not meet these criteria.

As a company that has been preparing to participate in the tendering process we find it difficult to make clear decisions when so much detail is yet to be finalized and where there are been little or no movement in specific areas of concern. The current proposals will dilute if not negate interest in participating in delivery of this critical infrastructure and at the very least raise questions about the ability of potential participants to be ready to tender in April 2009.

We would also note that the proposals advanced by Ofgem are in sharp contrast to the supportive steps taken by Crown Estates to facilitate Round 3 wind farm developments and also contrast with the support developers have in general from the government through the Renewables Obligation Certificates.

To achieve renewable generation targets government bodies are taking steps to create an environment that encourages developers to participate in the process and that ameliorates risk whereas Ofgem's current proposals for OFTOs transfers and increases the risk profile faced by those companies.

An example of this can be drawn out from the development of strategic infrastructure, that is, having the capacity to connect generation beyond the level of generation with planning consent. It is economic for OFTOs to develop infrastructure that is capable of collecting and connecting future developments, for example in relation to Round 3 developments. However, in an uncertain planning and a difficult operational environment this carries the risk that assets may become stranded at a later date exposing the OFTO to significant risk. This is likely to prove to be a barrier to developing vital strategic, cost effective infrastructure that is delivered on time or even undermining whether that infrastructure will be delivered at all.

The offshore transmission infrastructure associated with Round 3 projects will be costly and difficult to deliver. OFTOs must have the opportunity to bid for the early or the phased provision of infrastructure associated with a Round 3 Development Zone, and the regime must facilitate changes in the revenue stream as the infrastructure develops. A number of OFTOs designing and constructing within a single development zone will lead to inefficiencies, increased risk, additional costs and delays.

The structure of Ofgem's current proposals does not deal with these issues except to the extent that there is an expectation that relatively low return businesses will accept a 'stranding' risk, which is highly questionable.

In summary, for the regime to strike the right balance between protecting consumers and attracting sufficient competitive interest from prospective OFTOs, the following areas must be addressed as a matter of urgency

- Further consideration of explicit re-openers for revenue restrictions in the event of unforeseen and uninsurable events;
- Early and detailed reconsideration of ongoing operational incentives given the scale of exposure currently envisaged
- Reconsideration of the approach to tendering within a Round 3 Development Zone to accommodate phased infrastructure;

Specific Comments

Chapter 3 Overview of Regulatory Regime

We would expect that the next joint document would affirm the principle that the licensee will be able to recover efficiently incurred costs for any extension of the licence period. The key in the future will be to underwrite continuity of service provision. Ofgem must in the next consultation detail a process whereby a control can be extended by the existing party and only re-tendered as part of a competitive process where the existing OFTO wishes to cease operational interest, or as a contingency under situations where the existing OFTO might be in distress.

'Unknown Unknown'

We have consistently expressed that there is a need for clarity of when events could trigger re-openers. We acknowledge that the risks associated with some events might be mitigated using insurance products however there is likely to be significant volatility in, or the lack of ongoing availability of, the associated premiums.

It is not clear to us or brokers that we have spoken to, how insurance can be provided that will give us confidence that these type of unpredictable events will be fully covered. Although some such events may be included within policies that are broadly available at the time of bidding, by their unpredictable nature, policies are likely remain silent in respect of specific cover. As such, the effectiveness of the policy will only be tested when the unpredictable event occurs. As the regulatory regime currently stands, any possible adjustments for these unpredictable events will be considered on a case-by-case

basis. By taking this position Ofgem is in effect placing the risk with the OFTO, who has no guarantee that these events will trigger a re-opening of the mechanism, or that the insurance will provide adequate cover.

This could be resolved by putting in place arrangements that will trigger a re-opener when unpredictable events occur and where the associated insurance products prove ineffective.

It is essential that the regime addresses unknown unknowns effectively. The current proposal and the lack of clarity will inevitably lead to additional risks and costs, and difficulties in securing effective financing.

Known Unknowns

The latest proposal for 'Known Unknowns' does not address insurance premiums. Based on industry experience to date, premiums, particularly associated with offshore cables, will be high and volatile. Insurance will be key to effectively mitigating many of the known risks, however volatile premiums add further uncertainty. Premiums must be considered as known unknowns, and the volatility of premiums should be subject to re-opening the mechanism where changes are deemed significant, say +/- X% about inflation.

In addition to this, there may be situations where risks that have been identified and insurance is secured, however these risks become uninsurable at a later stage. In such cases the price control should be re-opened and a decision made whether the OFTO receives an additional allowance, or whether the ongoing risk is best taken by GBSO/consumers.

The regime would benefit from a more structured approach to financing where the development and construction, phase 1, and the operational phase, phase 2, are treated separately. Phase 1 could take a form similar to a TIRG style arrangement where the higher risk is reflected in a higher return during development. Under this approach the financing costs would effectively be passed through based on a forecast of investment expected during the construction phase of the works. The bidding process would in each case not include financing of the construction element but would reflect a post construction RAV, in a similar way to transitional projects, and would be based on the financing of this RAV post construction plus ongoing costs recovered over the 20 year revenue stream. Under this arrangement there would be no requirement to re-open the mechanism for re-financing. This would limit any risk premiums included by OFTOs to cover construction risk and therefore deliver a more cost effective solution for all.

Performance Obligations

We find the operational incentives and the availability penalty unacceptable. An OFTO will have little opportunity to spread this risk across large number of assets resulting in significant risk for individual projects. It is essential that incentives are considered on a project-by-project basis, giving the OFTO opportunity to negotiate, price, or withdraw if they feel that the exposure is unreasonable. We need to see more detail on the proposed structure of this incentive as a matter of urgency.

Chapter 4 Tender Process in the Transitional Regime

Pre-Qualification Stage

We feel that the structure of the Pre-Qualification Questionnaire is reasonable. We would suggest that for the first tranche of transitional tenders, where OFTOs may not be in a position to provide all information, Ofgem take a pragmatic view in the pre-qualification assessment.

It is essential that potential OFTOs are able to visit sites, including the offshore platforms or their construction site (if not completed) at the earliest opportunity in the tender process, potentially during pre-qualification preparation.

Invitation to Tender Stage

Data room

It appears from the consultation that the data room will become available at the ITT stage. As an OFTO prepares to bid it is essential that as much information as possible is made available, this will allow the OFTO to make an early, well-informed decision whether it is appropriate to bid. The data room should become available at the earliest opportunity, preferably at pre-qualification.

For transitional projects the extent and accuracy of the information within the data room will determine how effective the OFTO bids will be. This info must include all technical, environmental and consenting data employed in the planning and delivery of the project. Key information required within the data room must include:

All planning consents, and associated planning and operational conditions, including information used to build up the EIA.

Any specific agreement with bodies influencing offshore operations

Any agreement with parties offshore for cable and/or pipe crossings

Any agreements with landowners associated with onshore plant and equipment

Specification for all plant and equipment along with the response, proposal and final agreements made with winning contract bidders

Clear asset and responsibility schedules for onshore and offshore equipment

Any agreements with National Grid including the associated agreement under CUSC

Confirmation from National Grid as GBSO that the connection complies with the Grid Code

Confirmation from National Grid that the connection complies with the GBSQSS or any associated derogation.

Methodology for and results of quality audits undertaken during construction (or due to be undertaken)

Any warranty or ongoing agreements associated with the offshore transmission assets

Safety case for the ongoing operation of the offshore assets, including the methodology for safe operation of the platform and all associated equipment.

Provision of spare equipment and operations arrangements for planned and unplanned events.

Decommissioning plans and any associated agreements or bonds.

Where applicable the data room should demonstrate how the all legislation has been complied with, and include acknowledgement from the associated bodies that this is the case.

We re-iterate our view that performance incentives should be on a project specific basis and a default position is unrealistic.

Chapter 5 Pre-Tender Requirements

Market Information

For OFTO's early bid preparation, detailed market information is essential. For transitional projects developers will be well advanced (to meet pre-conditions) and as well as details of the onshore connection point, developers should make available the single line diagrams for the offshore transmission network, along with the cable routes and platform location/s.

Chapter 6 Tender Process in the Enduring Regime

We understand the objective of introducing a Request for Proposals stage, however Ofgem should give consideration to how this will affect the tender programme and OFTO bidding costs. If the Request for Proposals follows pre-qualification, it could add little benefit, as an effective pre-qualification should limited the bidders who can proceed to ITT. If Ofgem feel that the structure of the proposed PQQ will not adequately differentiate bidders for enduring projects, then a more detailed pre-qualification submission including some technical detail should be implemented.

The tendering programme will be key to securing an efficient design and an effective bid. The time taken to produce designs and secure prices should not be underestimated. The programme could be complicated by the length of time that a supplier's offer remains valid. It is essential that a mechanism is in place that will allow a preferred bidder to finalize costs and secure contracts before the final revenue stream is set.

The proposed programme for tendering enduring projects should be published by Ofgem at the earliest opportunity to allow open discussion with all stakeholders.

Role of the Stakeholders

The enduring regime will require OFTOs to design a suitable offshore transmission connection. Details of the generating plant are a key component of this design and information provided by the developer will influence the design. Any OFTO bid will be subject to the information provided at the time of tendering.

Section 6.23 and 6.25 discusses how National Grid Electricity Transmission (NGET) could provide Ofgem with details of which project will be tendered in a particular round and how they will assist in the assessment of the technical proposals provided by bidders. As a potential OFTO this information would provide NGET with a significant advantage and it is therefore paramount that NGET retains suitable separation from any OFTO interests within National Grid.

Tender Windows

We would agree that flexibility in the tender windows is essential to allow developers to proceed in a timely manner and also make the most of the opportunities to consolidate designs. It is however essential for OFTOs to have visibility in advance of the tender process to allow them to have adequate resources in place to manage their bids. This is particularly important for the first round of enduring project; we would ask Ofgem to indicate the earliest date that the first enduring tender will commence.

Consents and Leases

It is important that there are guidelines issued to wind farm developers for the design of the offshore assets that will ultimately be owned and operated by an OFTO, but consented by the developer. There is a risk that developers could obtain consents for offshore facilities that an OFTO would not be willing to construct.

Having said this the principle of developers securing offshore consents and leases would appear sound however it is essential that due consideration is given to the planning consent requirements of the onshore plant and circuits up to the onshore connection point. This should be incorporated within the EIA as this is accepted best practice. (see The Consenting Process for Onshore Generating Stations above 50MW in England and Wales, October 2007, DBERR)

Seabed Surveys

If the efficient cost of seabed surveys is to be borne by the successful bidder then these surveys must be fit for purpose and there should be no need for the OFTO to carry out supplemental surveys. If the surveys are no adequate then the costs should not be borne by the successful bidder and new surveys should be commissioned that provide the required information. The successful bidder should fund only adequate surveys. Clearly bidders will make bids contingent on the survey information provided to them.

Cost Recovery

Clarity on the costs that will be levied, and the extent and timing of refunds for bidding OFTOs is essential. In addition to Ofgem's costs, the bidders will be committing significant resources to a bid.

Within the Draft Template Invitation to Tender Document, 4.11.2 and 4.11.3 describe how the successful bidders will fund Ofgem's actual costs in running the tender process and states that unsuccessful bidders will receive refunds for any payments made. It is essential that this is made clear and consistent within the Tender Regulation and all supporting documentation.

We continue to be of the view that in order to maximize participation, OFTO's meeting the pre qualification criteria and continuing through ITT should have the ability to recover their economic and efficient tendering costs.