Legal, Regulation and Compliance
Millstream East
Maidenhead Road
Windsor
Berkshire SL4 5GD

Direct Dial: 01753 431 270

Monday, 28 July 2008

Mr Sam Cope
Offshore Transmission Team
Ofgem
9 Millbank
London SW1P 3GE

By E-mail: sam.cope@ofgem.gov.uk and offshoretransmission@ofgem.gov.uk

Dear Sam,

Re: Offshore Electricity Transmission – A Joint Ofgem/BERR Regulatory Policy Update, Centrica's final response

Thank you for the opportunity to respond to the Offshore Electricity Transmission Joint Ofgem / BERR Regulatory Policy Update consultation. This non confidential response is on behalf of the Centrica group of companies excluding Centrica Storage Ltd.

Offshore transmission arrangements are a vital prerequisite for meeting the renewables targets in 2020 and we would like to thank Ofgem and BERR for the extensive work to date.

Centrica remains committed to the Offshore Regime and whilst disappointed with the slippage in timescales we recognise the importance of getting the detail right. On that note, whilst there are a number of areas where we still have issues, a significant number of other issues have been resolved or clarified satisfactorily in this consultation.

In terms of general points:

- We are extremely disappointed that the charging methodology remains unconfirmed at this stage. This is a vital piece of the Offshore Regime and the additional risk introduced by the delay has the potential to stall investment decisions for projects currently in financial approval pipelines. This lack of detail on the charging methodology poses a real risk of jeopardising the UK's ability to reach the 2020 target.

- We welcome the additional flexibility introduced into areas of complexity and / or contention, for example, price adjustments, seabed surveys.

- We are reassured by Ofgem's general recognition that this industry deals with new and, to a large extent, unproven technologies, requiring heavy investment. Ofgem has reflected this in the policy document by building in reviews and flexibility for areas where there are a number of

Centrica plc
Registered in England No. 3033654
Registered Office
Millstream, Maidenhead Road
Windsor, Berkshire SL4 5GD

approaches possible. This review process will enable learning from the transitional regime to flow into the enduring regime tenders.

- Centrica believes it is very difficult for parties to continue with the design, planning and procurement processes for projects, currently at these stages of development, when the GBSQSS recommendations are simply proposals and the rules and implications of a derogation have not yet been ascertained. Early resolution of these requirements is also essential to keep the offshore wind projects on track.

Chapter 2: Design of the regulatory regime

In principle, Centrica does not support price reopeners during a regulated price control period. However, for the Offshore Regime, given the duration and unproven nature of the business we believe there is justification for limited reopeners. Centrica believes that there is substantial risk in not allowing re-openers in the absence of a periodic price control review.

- ***Revenue adjustments – should the regulated revenue stream be adjusted and, if so, how should this be designed?***

  We agree that "Unknown" unknowns can only sensibly be addressed on a case by case basis, but we believe that this leaves significant risks with the wider community which must be addressed. We suggest that clear criteria should be published in advance and, that before any adjustment is made, a full consultation is carried out together with a clear indication of the expected effect on charging.

  In terms of "Known" unknowns, we are not opposed, in principle, to adjustments in these areas, but we believe that such adjustments should only be available for those items which cannot be insured against at reasonable cost and where the OFTO has no influence over the costs, for example, Licence Fees. We are not yet persuaded that post construction re-financing is an appropriate inclusion in this category as the need for such refinancing is presumably known up front and can be planned for.

  As a general principle, if revenue adjustments are to be employed, they should occur in both directions; for example, if an allowance is made for Licence Fees and the costs are actually lower, this must also be passed through. OFTO revenues should be reported transparently and in sufficient detail to enable interested parties to appeal for revenue adjustments to be made where appropriate.

  If indexation is to be employed, it is essential that the selected index is fully transparent and accessible.

- ***Period of Regulated Revenue Stream***

  We remain convinced that a twenty year revenue stream is too short; it is inconsistent with the onshore arrangements, where a forty year term is used, and also with the duration of the Round 2 offshore leases which are for up to fifty years. We welcome Ofgem's proposal to keep this under review.

  On the ability for Ofgem to be able to grant revenues for shorter period than 20 years, where the tender process has not been effective, we are not opposed in principle. However, we believe that it is important to define, in advance, what effective means. We would wish to see such criteria being fully transparent and such decisions open to appeal (OFTO or generator). Whilst we recognise that the aim is to protect the generator it will also be important to understand the defect in the particular tender process, which has resulted in the shorter period, and the impacts of the shorter period. For example will more costs be front loaded? This approach must only be used as a final contingency measure and the implementation criteria carefully defined.

Centrica plc
Registered in England No. 3033654
Registered Office
Millstream, Maidenhead Road
Windsor, Berkshire SL4 5GD

In terms of Licences, we understand that they are open-ended unless revoked, such revocation being subject to a minimum term of 20 years and an 18 month notice period. We welcome Ofgem's additional flexibility re: course of action at end of 20 years which will depend on the generator's needs and statutory duties etc. This addresses our previous concerns regarding the short-term (e.g. three year) extensions to the existing twenty year revenue stream which may discourage the OFTO from maintaining the transmission assets to the same standard as the requirements during the twenty year period.

It is less clear how the revocation process would interact in terms of a re-tendering exercise should this be deemed necessary at the end of the 20 year term. The concern relates to the scenario where a new OFTO is appointed under such a tender exercise and whether more than one OFTO can have a simultaneous licence in respect of the same assets.

- ***Incremental capacity – what are your views on our updated position?***

  Centrica still believes that placing a cap of 20% on any incremental investment does not promote innovation, nor does it encourage the development of wind farms with additional capacity for future expansion. Twenty per cent does not appear to be sufficiently material to force a further tender process (which will incur costs on the offshore generator and potential bidders). The focus of the regime should be to drive down costs in the offshore arena and Centrica is concerned that this aspect of the regime will not meet this objective.

  Whilst too low, especially for Round 3 Projects, we agree that a threshold for inclusion of incremental capacity is a pragmatic approach. However, where such an approach is employed, we believe it should trigger an automatic review of the relevant charging methodology to ensure that the OFTO recovers only the efficient costs of providing the additional capacity and that all implications of recovering costs over a wider capacity base are properly examined.

  We are pleased to see the additional data regarding incremental work to accommodate changes post tender / pre construction, but would like further clarity how is this going to work in practice. Ofgem needs to ensure that this approach does not create any perverse incentives or manipulation of the flexible pricing options. E.g. does Ofgem select on the basis of the base case or upside incremental works? OFTO "A" might have a cheaper base case, but a more expense upside case than OFTO "B".

- ***What are your views on the appropriate structure and level of OFTO performance incentives; including how much of the regulated revenue stream should be exposed to such incentives?***

  Energy Losses Incentive: we agree losses should be a relevant factor at the project design stage and it is not appropriate to have an operational losses incentive.

  Capacity Delivery: Centrica agrees that this should be an asymmetric incentive and that the penalty should be proportional to the length of delay. However, there does need to be definition and clarity regarding what constitutes "extensive delay" versus "failure to deliver".

  The cap on the default level of exposure seems low at 10% and we would like to understand better Ofgem's rationale given it is based on other infrastructure projects, and to which industry sectors they apply. Please can Ofgem release the supporting analysis they have completed in this area?

  In addition, paragraph 2.31 suggests the OFTO penalty for delay should be capped to ensure the OFTO is still able to deliver. Are there equivalent safeguards for the generator who has invested and ready to generate? There appears to be little consideration for the potential generator losses and or compensation.

  Operational Availability Incentive: Centrica is in favour of asymmetric incentives providing the Operational Availability target is sufficiently onerous; Centrica would like to see an annual target of 98.5% or more. Wind farm economics are extremely sensitive to Operational Availability and if this

Centrica plc
Registered in England No. 3033654
Registered Office
Millstream, Maidenhead Road
Windsor, Berkshire SL4 5GD

target was set lower than 98.5% we would want see strong OFTO incentives to deliver to our higher requirement.

We also believe there is merit in setting reliability targets, as a measure of how many MWh the OFTO failed to deliver, i.e. how much power was disconnected and how often. We believe there should be an asymmetric incentive applied per outage in order to incentivise the OFTO to quickly repair a fault effectively, efficiently, and first time.

We would like further clarity on paragraph 2.36 where Ofgem believe it would be "difficult for OFTOs to manage [availability] over time since several major outages are likely during the lifespan of the assets". What is meant by "some form of 'Permit Mechanism'"? Is the availability target discussed above inclusive or exclusive of these outages? The latter will materially impact Centrica's view of the target figure discussed above.

Incentive Parameters: Centrica has no clear firm views on maximum levels of incentive, but 2% of the annual regulated revenue (annual or lifetime?) does not feel sufficiently penal given the impact on the wind farm generator, who relies on availability to generate both power and ROCs. On this basis we are assuming that Ofgem will consider best practice in other industries and revert. We welcome Ofgem's suggestion to retain flexibility and potentially adjust on a project specific basis.

Adjustment of Revenue to Reflect Incentives: We note that any penalties should be dealt with via a downward adjustment to regulated income and that this would be fed back through reduced transmission charges. Whilst sympathetic to the simplicity of this approach, it would be appropriate to ensure that the reduction is properly targeted and the impact on the affected generator taken into account.

Our further comments here are at a principle level. We believe that any incentive regime needs to be considered holistically to ensure that there are no perversities or unintended consequences. In addition, given this is a new and untried regime, we suggest any incentive regime is either short duration or has a forced review after [2] years.

The performance incentive (performance targets and penalty payments) should be set out in the offshore electricity transmission licence.

- ***What should be the role of the generator in defining the level and structure of performance incentives ex ante as part of their requirements?***

  The generator should be engaged in the development of OFTO targets to decide upon the appropriate completion dates and availability / losses targets.

  The resulting proposals need to be carefully reviewed and challenged by an informed, independent 3rd party.

- ***What actions should be taken in the event of persistent OFTO underperformance?***

  As a minimum, Centrica would expect a timely, revocation of the OFTO Licence, together with an immediate retender process, i.e. outside of the annual tender window process.

  Given the financial exposure for the generator in such circumstances Centrica would like to see a compulsory OFTO funded insurance scheme, similar to that seen in other exposed markets e.g. banking.

- ***Other Regulatory regime considerations.***

  In addition to the specific responses to Ofgem questions raised above, we have concerns in a number of areas related partly to the licence drafting and partly to the design of the regulatory regime. We have elected to address both sets of issues under this section.

Centrica plc
Registered in England No. 3033654
Registered Office
Millstream, Maidenhead Road
Windsor, Berkshire SL4 5GD

In general, we believe that detail is lacking, especially around aspects of the transitional regime such as the appointment of the OFTO of Last Resort (OFTOoLR) and associated obligations. For example, will we be able to add our costs of separation (one-off and ongoing) to the total project costs?

In respect of the details of the regime, we believe it would be helpful for Ofgem to share their thinking on detailed separation and ring fencing requirements, with potential OFTOoLRs at an early date. At present such details are lacking, making it very difficult to evaluate accurately the risks and obligations of acting as an OFTOoLR should this be required.

It is also important to consider the ring-fencing timescales, should a developer/generator be forced to become an OFTO of last resort, specifically as there is no requirement for a potential OFTO to acquire a transmission licence ahead of the tender process. There will be significant cost implications associated with the separation of a developer's generation and transmission businesses. These costs, combined with the EU unbundling risk, may deter a generator from becoming an OFTO of last resort and result in stranded offshore assets.

Finally, Centrica still has serious concerns that there will be no OFTO of last resort for the enduring regime. As a major offshore generator, Centrica requires confidence that its future projects will be provided with connections to the onshore transmission system. We would be interested to understand Ofgem's contingency arrangements to mitigate this risk.

Chapter 3: Tender process, including transitional arrangements

Generally, whilst we remain concerned with the annual tender window, we welcome Ofgem's intention to review the fixed window tender approach after experience of the transitional regime and the proposal to retain the flexibility to commence tenders at a different point, where necessary.

- ***The proposed pre-conditions for the enduring tender process, and in particular whether there are any other pre-conditions that it would be appropriate to consider.***

  Centrica supports the pre-conditions for the enduring process. We also welcome the proposed additional flexibility in paragraph 3.38 where a generator in the process of seeking a CUSC bilateral connection agreement, can enter the next available tender round. We also welcome the proposed option to delay entry if the connection date is a number of years out.

- ***The proposed approach for treating seabed surveys in the enduring regime.***
  Centrica supports the flexible approach to this issue provided the generator is fully remunerated and assumes the generator would set out his available / required surveys as part of the data room process.

- ***The proposed linkage between the tender process and the connection process.***
  Centrica agrees that it is more appropriate to commence the tender process upon generator acceptance of the initial connection offer as significant tender costs could be incurred prior to this acceptance, and it is feasible that the generator could reject the offer on the basis of an unsuitable connection date, location, or planned technical design.

- ***The proposed approach for OFTOs to provide construction security.***
  We agree with the approach and for the OFTO to provide securities to NGET under the STC. Given the critical nature of the OFTO's role and the parallel investment by the generator then the security should be set at 100%. This will reflect the generator's commitments for the grid connection.

Under this chapter, in addition to the specific questions raised above, we would like to raise the following points:

In terms of the RAV assessments, the proposals seem broadly reasonable, but we would welcome further clarity in terms of the criteria to be used by Ofgem in judging an efficient level of investment. We

Centrica plc
Registered in England No. 3033654
Registered Office
Millstream, Maidenhead Road
Windsor, Berkshire SL4 5GD

are also of the view that it would be appropriate for there to be some form of appeal mechanism against Ofgem's valuation in defined circumstances.

Even with the delay, the Go Active date is fast approaching and Centrica requires certainty on the data requirements and the associated deadlines to enable Ofgem resources to determine the RAV for the adoption of Barrow Offshore Wind.

Centrica supports the role of generators in triggering the tender process, populating the data room via GBSO, and considering variant bids. We also believe that is essential for the developer to be involved in assessing and selecting the revenue stream.

Chapter 5: Licence Drafting

- ***Does the licence drafting reflect Ofgem/BERR's policy positions?***

We are satisfied that the licence drafting broadly reflects the policy decisions expressed. However, whilst understanding that certain decisions have been made, we have raised additional concerns above (in the section on the regulatory regime) which we believe should be addressed. This process might lead to additional changes being required to the licence drafting.

- ***Are there any other issues that should be addressed through licence changes?***

See above

- ***Other***

In addition to the comments above, we would wish to make some further observations:

In para 5.19, Ofgem correctly identifies a risk of NGET subsidiary companies being placed at a potential commercial advantage. It is essential that this not be permitted. Ofgem has identified one possible preventative measure, that of prohibiting NGET from forming OFTO subsidiary companies. Whilst this is one option, we would not wish to preclude NGET from participating in the new arrangements and we believe it should be possible to achieve the same result, by seeking a CUSC amendment to prevent specific disclosure of data to OFTO subsidiaries.

Regarding the Special Conditions, we understand that these will be specific to the OFTO, however, in common with the existing licences, we do not see why elements cannot be standardised and, in particular, the majority of the text should be available as a template for review and consultation, leaving only details specific to the individual OFTO to be filled in later. On this basis, we hope that Ofgem will initiate a full consultation on the draft Special Conditions shortly.

Considering specifically the reporting provisions, we welcome Ofgem's recognition that proportionality is required, however we urge that the key principles of timeliness and transparency should be maintained.

A number of conditions in section A of the draft standard conditions make reference to the subsequent sections applying "in whole or in part". We would appreciate clarification as to how this might operate and whether, in fact, in the case of OFTOs, Ofgem would simply envisage switching whole sections on and off.

Looking at condition E14, we are in agreement with the general approach, but will reserve any more detailed comments until the full drafting is available.

Centrica plc
Registered in England No. 3033654
Registered Office
Millstream, Maidenhead Road
Windsor, Berkshire SL4 5GD

Chapter 6: Technical Rules and Industry Codes

- ***Does the drafting in the annexed codes accurately reflect the policy positions set out in this document?***

BSC
Centrica is in broad agreement with Ofgem and Elexon in terms of the changes required to the BSC, in particular that there is no additional categorisation of metering required. It is clear to us, however, that there are likely to be a number of changes required to BSCP subsidiary documents, and consideration needs to be given to how the practicalities of meter registration, proving, assurance, validation, etc are to be performed by the CDCA agent.

BSCPs 02, 06, 20 and 27, inter alia, are likely to be affected, as well as the CDCA Service Description documents, and it would be wise to examine changes required now, such that registration and management of new offshore metering systems are not subject to delays.

Grid Code
Centrica is generally supportive of the proposed amendments to the Grid Code that have been put forward by National Grid.

Centrica considers the offshore ownership and interface boundary to be fundamentally correct but would like National Grid to consider the inclusion of ownership and control of the 33kV switchgear within the offshore generator's remit.

Centrica seeks further clarification on the offshore GEP / GSP, specifically in relation to metering, ROC determination, TEC classification, and the resultant changes to existing connection agreements with National Grid if the metering point is moved from its original onshore location.

Centrica understands that the various Grid Code requirements will be imposed on any wind farm greater than 10 MW. This will include various technical requirements such as frequency response, reactive power provision, fault ride through and the need to have a control point. Please can you provide further information regarding the choice of threshold? In addition we would expect the offshore generator to be remunerated for the provision of any reactive power in line with the arrangements onshore.

SO-TO (STC) Codes
Centrica considers that the STC governance and code proposals in respect of OFTOs are satisfactory. Centrica welcomes further work on OFTO cost recovery where works are triggered by onshore infrastructure development.

Centrica welcomes consistency with onshore arrangements. However, how well these codes can be applied in an offshore environment, with potentially different technologies / arrangements, will need to be monitored. Centrica's view is once the equipment is commissioned there should be relatively few issues, not least because underground cables have fewer problems than overhead lines. However, during commissioning there is likely to be significant engagement of a number of related parties covering their own activities. Consideration should be given to a single commissioning party approach and hand over.

GBSQSS
Centrica remains concerned with National Grid's redundancy proposals. As wind farms continue to expand in size it is increasingly unlikely that the total wind farm capacity will be able to be accommodated by a single transmission cable / circuit. We believe the costs of a double circuit arrangement will already be required by most future developments.

If the redundancy proposals remain, it would be useful to know much generation National Grid will allow to be provided on a single circuit offshore cable?

Centrica plc
Registered in England No. 3033654
Registered Office
Millstream, Maidenhead Road
Windsor, Berkshire SL4 5GD

Additionally, Centrica would like to challenge National Grid's proposal for a double busbar recommendation at both the onshore and offshore substations when existing projects have not been designed or constructed with such an arrangement in place.

Furthermore, Centrica seeks information from Ofgem concerning derogation for transitional projects where areas of the design are over-compliant, whilst others do not fully conform to the GBSQSS recommendations as they currently stand. Centrica believes it is very difficult for parties to continue with the design, planning and procurement processes for projects currently at these stages of development when the GBSQSS recommendations are simply proposals and the rules and implications of a derogation have not yet been ascertained

Similarly, Centrica requests clarification on the compensation allowances where GBSQSS redundancy requirements can be partly met in one area of design whilst over-complying in another.

Centrica feels that the GBSQSS needs to further address the level of Offshore Power Station Demand as it is not acceptable to strand wind turbines without sufficient back feed from the Grid during maintenance, following an unplanned outage. Such periods of inactivity could render the wind farm components inoperable due to the volatile and harsh conditions offshore which could impact the start-up of the turbines if left static for a number of weeks.

As mentioned above, if the solution to providing a higher level of Offshore Power Station Demand drives increased redundancy requirements in the form of additional cables and circuits, this investment decision may have already been taken on another basis for the majority of existing and future transmission projects (i.e. as a result of capacity limits in the cables – as above). Standby generation as an alternative solution is not to be ruled out, however, there will be a cost implication on the offshore generator that could otherwise be avoided through an alternative planning approach / design adopted by National Grid. Consideration needs to be given to the contractual, interface and charging arrangements where this back-up generation could also be utilised by the OFTO.

Centrica is concerned that the GBSQSS proposals as currently set-out by National Grid could be restrictive and provoke a further review with the advent of larger Round 3 projects further offshore. Efforts should be made during the present review to prevent timely and disruptive amendments in the short to medium term.

Connection via Distribution Systems

Centrica is becoming increasingly concerned at the time taken to devise the charging arrangements for Embedded Transmission projects. Such projects are not currently obliged to pay transmission charges and thus any obligation to change that will have a detrimental effect on the project economics. Centrica encourages Ofgem and BERR to drive forward the determination of an Embedded Transmission Charging regime and to also consider an interim compensation payment to projects currently not liable for transmission charges.

Centrica agrees with Ofgem's "minded to" approach not to make it a requirement for all future connection applications to consider a distribution connection unless specifically requested by the offshore generator. This will save time in the planning and delivery of offshore wind projects. Centrica would like to understand Ofgem's willingness for the continued development of distribution connected projects.

Centrica supports National Grid's proposed drafting amendments for both the DCUSA and the Distribution Code.

Chapter 7: Transmission charging, access and compensation

There are serious concerns regarding the delay to the charging regime which is vital to any business' decision to build, own and / or operate an offshore wind farm. We understand Ofgem's concerns but would urge that the matter is resolved as soon as possible to prevent any loss in confidence from potential investors.

Centrica plc
Registered in England No. 3033654
Registered Office
Millstream, Maidenhead Road
Windsor, Berkshire SL4 5GD

In addition, we have some significant concerns around the charging methodologies. We note the text in paragraph1.29 that charges would be recovered in accordance with the agreed charging methodology in place at that time. We believe that leaves the relevant generators exposed to the risks that changes in such methodologies may have significant impacts on them in the future. With this in mind we believe it is essential to ensure that all those affected by such charges have the ability to propose changes which will better facilitate the regulatory objectives, not just the network operator(s).

Whilst this will clearly not change the overall levels of revenue secured by the OFTO, it could lead to major changes in the pattern of collection, having significant cashflow impacts on both OFTOs and generators. We believe this distribution of risk should be appropriately recognised in the returns available to the OFTO.

Regarding views sought on the approach to the following issues:

- ***The mechanism for compensation arrangements for offshore generators should be defined in the CUSC.***
- ***The mechanism for the OFTO funding of any compensation payable in respect of availability of the offshore transmission system, to the offshore generator should be set out in the STC.***
- ***The performance incentive (performance targets and penalty payments) should be set out in the offshore electricity transmission licence.***

Centrica understands that, regardless of offshore connection, offshore generators will be compensated for a loss of access where this was due to a problem on the onshore network. The outstanding issue is how offshore generators should be compensated for loss of access due to a problem on the offshore network. We would like to understand better why Ofgem is not in favour of the option to apply the current compensation mechanisms in the CUSC on an offshore transmission system. If Ofgem were to share the supporting analysis, this would help respondees understand how the latter compares with Ofgem's proposal, that an offshore generator would be compensated for lack of access if an OFTO fails to meet its annual performance target (and that the amount of compensation should not be higher than the imposed penalty) under the incentive scheme.

Finally, Centrica would like to thank Ofgem, BERR, National Grid, Elexon and the other parties contributing to the policy update. The additional detail is useful and we would urge Ofgem to complete the tender process and charging regime as a matter of urgency.

We would be happy to meet and discuss any points raised here in more detail.

Yours sincerely,

By e-mail

Fiona Navesey
Business Development Manager (Power)
Business Development
Centrica Energy