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Offshore Electricity Transmission - A Joint Ofgem/BERR Regulatory Policy Update June 2008

Dear Colin,

We welcome the opportunity to respond to this Regulatory Policy Update. This response is provided on behalf of the RWE group of companies, including RWE Npower plc, RWE Supply and Trading GmbH and RWE Innogy.

GENERAL COMMENTS

The document reaffirms, refines and updates a number of the elements that will comprise the proposed offshore electricity transmission regime. It also highlights those aspects of regime design where updated proposals require further consultation. There is also a consolidated consultation on the changes required to the various industry codes, agreements and licences to implement the regime. This in itself represents a significant body of work and whilst the Secretary of State may designate certain aspects, many changes will be effected under standard industry governance and we welcome the additional consultation time.

In general, the regime details are becoming clearer and more stable, but there are still areas where there is significant uncertainty for developers and prospective OFTOs. These include potential changes to the transmission charging arrangements for offshore, the interaction between the connection and tender processes and adjustments to the revenue stream. Whilst we are committed to delivering and operating under the proposed regime, we remain of the view that the overall framework is very complex and lengthy, creating the potential for significant risk and delay for project developers and uncertainty for potential OFTOs. Together, these may reduce developers' willingness to initiate new projects and slow down existing ones. This will inhibit rather than support the overall policy objectives of connecting generation offshore. We have set out our detailed responses on the consultation questions below. Our comments are focused on

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chapters 2 and 3 and elements of the drafting for the Transmission Licence and Grid Code.

Chapter 2: Design of the Regulatory Regime

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

The level of uncertainty and risk faced by an OFTO will be factored into their tender offer. There is clearly a balance to be struck between pre-defined adjustment mechanisms and allowing bidders to manage certain risks that are within their core competence. We endorse the proposal to apply indexation to “known unknowns” but agree that management of “unknown unknowns” is a key differentiator between bidders and may provide competitive advantage so the regime should not be overly prescriptive.

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

The proposed regime is all about point to point licenses awarded competitively so it is not clear that any OFTO will include any redundancy over and above that which has been specified in the tender on the basis that it may never be remunerated. On this basis, to be consistent with the regime any incremental request must surely trigger a new tender. Whilst the incumbent OFTO may be best placed to provide any incremental capacity most efficiently in the tender, the regime itself provides little incentive to OFTOs to provide additional flexibility in anticipation of future requirements.

- *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?*

Given that the proposed regime is based around providing radial rather than meshed connections, the OFTO availability incentive needs to recompense the generator for the opportunity cost of not generating because if the network is unavailable, the generator has no way of getting its power away. The target availability of 97% still appears arbitrary and it is important that there is some justification for it, given higher availability figures that are in the public domain. This, together with the proposed mechanism to help the OFTO mitigate the risk of major outages, weakens the intent of the incentive. There is a risk that in the case that the incentive penalty costs are less than the maintenance costs, the OFTO might choose to take the penalties. On this basis, the penalties should not be capped or, as a minimum, be set high enough to ensure that maintenance is carried out. We have included a detailed example in the confidential appendix included with this response to highlight our concerns in some more detail.

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

Where a generator requests a connection in excess of the minimum requirements dictated by GBSQSS, then this is likely to result in an electrical system offering improved availability. The OFTO incentive scheme should be flexible enough to recognise and adjust to this scenario. For example, in this situation OFTO penalties would be incurred if the system failed to deliver a higher level of availability as compared to the GBSQSS base case availability.

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

Essentially this is a matter for BERR and Ofgem in their ultimate design of the Transmission Licence. However, the absence of an OFTO of Last Resort in the enduring regime does create the potential risk to the generator that if a transmission licence is rescinded then they will be unable to generate and be exposed to lost revenue until another OFTO has been appointed. This places the onus on the initial selection and ongoing monitoring of the OFTO to ensure that they remain viable and we would also like to see an interim process put in place that provides the generator access to market or compensation between failure of one OFTO and appointment of another. Clearly these interim arrangements must be robust and capable of being put in place quickly.

Chapter 3: Tender Process (including Transitional Arrangements)

- *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.*

These pre-conditions appear to be reasonable.

- *The proposed approach for treating seabed surveys in the enduring regime.*

It is not obvious to us how the offshore developer can provide a seabed survey as the nature of the two-stage connection process suggests that the final onshore landing point may not be determined until the end of the process. For instance, there may be options depending upon whether the landing point is reliant on planning permission for the associated onshore connection works. There will be a trade-off between costs and the likelihood of a timely connection and Ofgem will need to factor this into its determination of what constitutes an efficient tender. Bidders will be best placed to manage this process.

- *The proposed linkage between the tender process and the connection process.*

This is a complex element of the process and although a parallel approach to certain activities would expedite the process, the incentives within the regime lead to a sequential approach. There will be an interaction between NGET and the OFTO that may result in a variation to the initial offer and this may impact on the offshore developer, reinforcing the argument that the regime forces a sequential approach.

Another issue that is for further development is how Ofgem will assess bids, variant bids and make certain assessments, such as whether a tender is competitive or not. We look forward to seeing the documentation associated with the tender regulations.

- *The proposed approach for OFTOs to provide construction security.*

We agree that there needs to be a mechanism for OFTOs to provide construction security. Given that failure to complete construction of the transmission assets may jeopardise the viability of the offshore generation project, 100% of the costs should be secured.

- *The proposed approach that the preferred bidder will make its offer of construction through the normal STC process.*

We agree that this is appropriate.

Chapter 5: Licence Drafting

- *Does the licence drafting reflect our policy positions?*

One of the principles behind the approach to the offshore transmission regime has been one of light-touch regulation, exemplified by the licensee receiving a 20 year regulated revenue stream, rather than being subject to a five-year periodic review. The licence drafting is inconsistent with this light-touch approach in a number of areas and, we would argue, imposes onerous obligations on OFTOs, particularly where the OFTO holds multiple licences.

The process by which the Transmission Licence has been drafted is to add in a new *Section E: "Offshore transmission owner standard conditions"*, largely based on the current Section B: *"General"* conditions. Although this is a legitimate starting point, we believe that some of the reporting requirements and other requirements designed for large scale monopoly transmission owners subject to periodic price control are not appropriate for OFTOs. We do recognise that Ofgem must balance more relaxed requirements with its duties to ensure that the OFTO remains financially viable through time, especially in light of the range of financial structures that it is expecting through the tender. Another area where further consideration of the relevance of the condition to an OFTO includes: E17: *"Prohibition on engaging in preferential or discriminatory behaviour"*. When reviewing the Licence, Ofgem should consider the purpose of each condition and its relevance to an OFTO licensee.

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

The impact of the Fuel Security Code and clarification of the Standard Condition veto provisions need to be clarified.

Chapter 6: Technical Rules and Industry Codes

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

The main body of the consultation makes little or no reference to the generator offering reactive range above the minimum Grid Code requirements. This is mentioned in one or more of the Annexes, but it suggests that this is 'by agreement'. Given that the cost of any onshore SVCs shall be recovered from the generator then surely the decision on the reactive solution should be with the generator. This would be consistent with the existing range of interactions between the developer and OFTO during the tender process. We have provided an example of potential cost benefits in the confidential appendix.

Clause 1.12 in Appendix 5 suggests the generator shall be able to group WTG strings into BMUs so long as they are all connected to the same single busbar section. Given that the GBSQSS draft calls for a double busbar then there is no guarantee that any two strings will be connected to the same single busbar. Further clarity is required here.

The current grid code requirements for Power Park Modules link the reactive capability requirements to the capacity of generation connected at any given time, i.e. Clause 6.3.2 (c) includes the sentence 'These Reactive Power limits will be reduced pro rata to the amount of Plant in service'. The technical requirements placed on the OFTO with regard to the provision of reactive capability does not link the required capability to the connected generation capacity, i.e. the above sentence does not exist in the draft STC. This creates a problem where an offshore generator elects to provide reactive capability from the offshore generators (i.e. assisting the

OFTO in meeting their onshore obligation) as the generator can only provide range in proportion to the capacity of their connected generation. This could theoretically prevent the generator from offering up reactive range.

We have provided a confidential response as a separate attachment to this document.

We hope these views are helpful and would be happy to discuss them further.

Yours sincerely,

By email so unsigned

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