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## **Offshore Electricity Transmission A Joint Ofgem / BERR Regulatory Policy Update**

Scottish and Southern Energy (SSE) welcomes the publication of Ofgem / BERR's policy update on the regulatory regime for offshore electricity transmission.

This publication marks a significant step forward in setting out the detail of Ofgem / BERR's proposals for the regulatory regime, in particular the proposed structure of the electricity transmission licence and changes to industry codes. There remain, however, a number of areas where the policy is unclear, notably the measures to ensure optimum performance and availability of the offshore transmission asset, and the arrangements for transmission charging, access and compensation. Work in these areas needs to be progressed as a matter of urgency.

We remain of the view that many developers of offshore power stations will seek to progress an integrated generation and transmission model, as the most economic and efficient solution to the many technical challenges of working offshore. This approach would have clear benefits to consumers as they would be shielded from the risks of offshore transmission, and the associated costs.

Our detailed response to the consultation is attached. Please do not hesitate to get in touch if you would like to discuss the issues raised in our response further.

Yours sincerely,

**Aileen Mcleod**  
**Regulation Analyst**

## **2. Design of the Regulatory Regime**

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

Without provisions to adjust the regulated revenue stream, offshore transmission asset owners would face higher risk premiums resulting in higher overall costs to the generator and GB consumer. Consequently, we welcome Ofgem / BERR's decision to include provision in the regime for adjustments due to exceptional events and in certain pre-defined circumstances.

We believe that provision for such adjustments should be made on a case by case basis with bidders for an offshore transmission asset owner licence being required to identify areas of uncertainty and propose mechanisms for addressing these. Similarly, Ofgem should be required to identify those circumstances where it would seek to adjust the regulated revenue stream. Provision for adjustments should be agreed during the tender process and then set out in the licence.

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

Ofgem / BERR's proposed approach to investment in incremental capacity presents a significant risk to potential offshore transmission asset owners and, as a result, offshore generators. An application for new transmission capacity (over which the offshore transmission asset owner has no control) could happen at any time during the regulated period and may result in the revocation of the offshore transmission licence. There are a number of approaches the offshore transmission asset owner could take to mitigate the effects of this, all of which are likely to result in higher overall costs.

Consequently, we are concerned about the proposed prescriptive application of an automatic re-tender at the 20 per cent threshold. This would expose asset owners to the risk of enforced sale (at an unspecified level of compensation) triggered by the business decisions of other parties outside the control of the incumbent asset owner. We believe there is merit in considering a more flexible, pragmatic approach that would allow the existing offshore transmission asset owner to respond to a request for increased capacity before re-tendering is initiated.

Subject to the outcome of a detailed economic and engineering review of the incumbent's proposals and open consultation (in particular with the affected generators), the existing offshore transmission asset owner could have its licence extended. This would avoid the costs, uncertainty and delay associated with re-tendering and, potentially, asset transfer.

*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?*

The offshore transmission asset is a potential single point of failure for the offshore generator; hence, from the perspective of the generator, it is absolutely critical that the transmission asset is constructed and maintained to a standard that seeks to maximise operational availability and

performance. While this is, in large part, dependent on decisions made during the tender process, it is also important that the offshore transmission asset owner has appropriate incentives post-construction.

We recognise that a balance needs to be struck. The costs associated with maintaining offshore transmission assets are, relative to onshore, high. For example, standard vessel hire can cost up to £80,000 per day and this cost will be much higher in the event of emergencies. Financial penalties that are not balanced with the levels of costs likely to be incurred by the offshore transmission asset owner are likely to be ineffective. Furthermore, the mechanism for applying performance incentives must be balanced to ensure that the expectation of penalties does not mean that such penalties simply become pass-through costs that are factored into a bidder's revenue stream in lieu of maintenance expenditure.

There is scope, we believe, for utilising a basket of performance measures where a number of factors are taken into account when coming to a view on the overall level of performance and, hence, an appropriate level of penalties. For example, an offshore transmission asset owner who seeks to minimise the unavailability of their assets by actions such as active maintenance and emergency vessel contracts would be assessed as having a high overall level of performance and consequently could be exposed to lower penalties than asset owners who have not taken such actions.

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

As described above, the offshore transmission assets provide the thin lifeline between the generator and its market. Consequently, during the design phase the generator is required to make an important trade-off between the capital cost of the link (recovered through transmission charges) and compensation for lost opportunity in the event of unavailability or poor performance (either through industry arrangements or by insurance). It is at this point that the generator must make a decision over whether or not to proceed on the basis of the proposed terms for the transmission infrastructure. This means that the involvement of the offshore generator in the tender process is absolutely critical and, furthermore, unavoidable.

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

In the first instance, the regulatory regime should be designed in such a way as to minimise the scope for persistent underperformance of the offshore transmission asset owner. Persistent underperformance is likely to severely impact on the ongoing viability of the offshore power station and, in such circumstances, the offshore generator should have the right to require Ofgem to initiate remedial measures that may ultimately result in the revocation of the offshore transmission licence and the establishment of fit-for-purpose transmission services going forward.

### **3. Tender Process (including Transitional Arrangements)**

Critical to the success, or otherwise, of transitional and enduring arrangements for the ownership of offshore transmission assets is that an experienced, competent owner is identified in a timely manner and at no greater cost or risk than if the offshore generator had maintained ownership of the assets. Hence, in assessing Ofgem / BERR's proposals we are particularly mindful of:

- The exposure of the generator to non-availability or poor performance of the offshore transmission assets.

As described above, we believe that the primary criteria of the tender process should be to ensure that the transmission asset is constructed and maintained to a standard that seeks to maximise operational availability and performance. This, necessarily, will require involvement from the offshore generator during the tender process.

- The risk of failure of the offshore transmission asset owner.

We welcome the strengthening of the draft licence conditions that seek to ensure the financial viability of offshore transmission asset owners. However, we note the retention of the proposal that licensees need not maintain an investment grade credit rating. This would appear to allow highly leveraged entities to become offshore transmission asset owners. Clear guidance as to what Ofgem would accept in lieu of an investment grade credit rating is necessary to alleviate our concerns in this area.

- The connection and use of system charges.

We set out our concerns below about the proposed arrangements for transmission charging, access and compensation. The access framework needs to be clear and sufficiently certain during the tender stage to ensure that offshore generators and prospective offshore transmission asset owners have robust information to judge the viability of their developments.

- The cost (in time and money) of the tender process.

We support a tender process that is as short as possible and seeks to avoid unnecessary steps in the bidding process.

Under both the transitional and enduring regimes, there are a range of interdependencies between the offshore power station and the offshore transmission assets that are not recognised in the policy document. For example, consents are likely to be obtained by the generator and then will need to be separated; there needs to be co-ordination of timing in the construction of the power station and transmission link; and there needs to be co-orientation in the development and use of shared facilities. For the transitional regime, projects have been developed on the basis of integrated transmission and generation, and the policy document does not consider the appropriate separation of liabilities on adoption.

In response to previous consultations, we have commented that the proposed regime (transitional and enduring) does not preclude the developer of the offshore power station

progressing the consenting, design and construction of the transmission asset. Given the criticality of the transmission link to the power station, and the complexities of achieving co-ordination in timing and financing, we believe that many developers will prefer this approach.

The option of the developer progressing the transmission link would not only address many of the issues of allocating the costs and risks associated with design and construction, but would also minimise the exposure of the GB consumer. In the first instance, with the developer progressing the link effectively 'off line' consumers would not be involved. Further, this would minimise the costs associated with licensing the network assets.

## **5. Licence Drafting**

*Does the licence drafting reflect our policy positions?*

Yes.

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

No. The draft standard licence conditions published as Annex 1 to the consultation are, subject to the detail of the drafting, comprehensive. User-specific conditions, such as those setting out restrictions on revenue recovery, performance incentives and termination provisions, should rightly be included in the special licence conditions.

We note the proposal to revise standard licence condition C11 to require the System Operator to include in the Seven Year Statement network information that would assist an offshore developer. This would appear to duplicate the existing provisions of standard licence condition C11 which requires the System Operator to publish "*such further information as shall be reasonably necessary to enable any person seeking use of system to identify and evaluate the opportunities available when connecting to and making use of such system*". As such, we question the value of this proposed change.

We also note the proposal to introduce a licence obligation on the System Operator to provide Ofgem with a Construction Application once an offshore generator has entered into a Bilateral Connection Agreement. Again, this would appear to duplicate the provisions of draft standard licence condition C8A where the System Operator is required to make available to the Authority "*such necessary information as is required for to facilitate the selection of an offshore transmission owner and the production of an associated TO offer*". Considered drafting of standard licence condition C8A would, in our view, avoid the need for a further new licence condition.

## **6. Technical Rules and Industry Codes**

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

Broadly, and subject to our detailed comments below, yes.

We note that the definition of *Force Majeure* may require to be revised in light of the particular characteristics of offshore transmission assets, the operating environment and the potential materiality (through the performance incentive) of events resulting in network unavailability. We support, as far as is possible, a common definition of *Force Majeure* across the licence and industry codes.

The changes proposed are wide-ranging and, in many instances, complementary. Hence, prior to implementation, we would support the engagement of an independent solicitor to review the changes with the purpose of ensuring cross-governance consistency.

#### Balancing and Settlement Code (BSC)

We have no objection to the proposed changes to the BSC.

#### Connection and Use of System Code (CUSC)

The modifications that will be required to the CUSC are, in large part, dependent on the final framework for charging, access and compensation. We comment on the proposals for charging, access and compensation in our response to Chapter 7 (below), and also make the following observations about the proposed amendments to the CUSC:

- Interdependency with the tender process: the proposed changes to the CUSC have cognisance of the requirement to modify bilateral agreements following the appointment of the offshore transmission asset owner. Such modifications should be reasonable and the user should retain the right to refer these agreements to Ofgem (for example, see clause 1.2.3 of the draft Offshore Construction Agreement). Further, where the System Operator is given the right to terminate agreements in relation to the tender process, this should only be as a result of actions within the users control.
- Treatment of restrictions on availability: the proposed changes to the CUSC include new section 2.13.7 that allows for the inclusion of 'clause 10' provisions within the bilateral connection agreement. These provisions can only be developed after the offshore transmission asset owner has been appointed and the final network design agreed. This means that these provisions will be introduced as a modification to the bilateral agreement; hence, again, it is important that such modifications should be reasonable and the user should retain the right to refer these agreements to Ofgem.

We support the proposal to offer all offshore generators a bilateral connection agreement and, where required, for the System Operator to manage the interface with the distribution network.

#### Distribution Connection and Use of System Agreement (DCUSA)

We have no objection to the proposed changes to the DCUSA. For 'embedded' transmission assets, a number of codes will apply and we note the need to ensure consistency in, for example, the allocation of liabilities across the DCUSA, CUSC and STC.

### Distribution Code (DCode)

We have no objection to the proposed changes to the DCode.

### Grid Code (GCode)

We have no objection to the proposed changes to the GCode. We agree with the need for consequential changes to the STC.

### System Operator – Transmission Owner Code (STC)

We agree that the current STC governance procedures should be revised to accommodate new offshore transmission asset owners, and support the conclusions of the STC working group. However, the proposed drafting to incorporate the new arrangements is unclear and appears to result in perverse outcomes. We believe that this should be reviewed for consistency in application and intent.

We believe that it is important for any party considering ownership of offshore transmission assets that they have choice over system control. For example, the asset owner should be able to own and operate its own system control facilities or should have the ability to sub contract to a third party of its own choice. Restrictions in this area would, we believe, reduce interest in becoming an offshore transmission asset owner. Drafting of the STC should reflect that it is the responsibility of the asset owner to ensure appropriate system control facilities are in place. We expect that the system control proposals of prospective offshore transmission asset owners would be subject to detailed scrutiny during the tender process.

We support the proposal to dis-apply requirements for active involvement by the offshore transmission asset owner in joint investment planning processes unless a specific need has been identified.

We note the particular issues around the connection offer process. We agree that, as far as is possible, the process in the STC should mirror that in the CUSC. That said, it is likely that only the second part of the application process – once an offshore transmission owner has been identified and bilateral agreements are being finalised – will be included in the STC. Prior to that there will be no STC party to which the System Operator could apply for a Transmission Owner Construction Offer.

We recognise the potential benefits of standardising, for example, agreements, information transfer requirements and ownership boundaries in the STC. However, it should be recognised that each connection to the network is different and the transmission asset owner needs the discretion to deal with each on a case by case basis. Consequently, we would view such standardisation as a guide only, and would not support placing an obligation on the offshore transmission asset owner to use the standardised forms.

It is not clear to us why the offshore transmission asset owner should be required to provide securities to the System Operator during construction of the offshore transmission system. Any costs that the System Operator incurs during construction will be underwritten by the offshore

generator (who will also underwrite the costs of the offshore transmission asset owner). Consequently, we do not understand what liability it is that the offshore transmission asset owner would be securing and hence do not support this proposal.

Under the current arrangements, the recovery of the costs associated with third party works are such that an offshore transmission asset owner would only be responsible for the costs of any works that were triggered by changes on its network. The proposed regime for offshore transmission means that such changes are highly unlikely. While we note the proposal to revise the procedures for recovery of the costs of third party works in the STC, we are not clear what defect this is intended to resolve.

#### GB Security and Quality of Supply Standard (SQSS)

We have no objection to the proposed changes to the GB SQSS.

## **7. Transmission charging, access and compensation**

A clear framework for charging, access and compensation is absolutely critical for any offshore generator. Generators require clarity and certainty over the terms for access to the system, the costs of connecting to and using the system, and compensation arrangements in the event of poor performance or unavailability of the system. This policy update, in our opinion, does not provide sufficient detail on the framework for transmission charging, access and compensation and this should be addressed as a matter of urgency.

We also note the wider framework changes that are being proposed for transmission access and charging following the final report of the Transmission Access Review. It is important that any changes that result are also fit-for-purpose for offshore generators and do not contradict or undermine other policy decisions being made for offshore transmission and the objectives of the Renewable Energy Strategy, which is seeking a major contribution from offshore wind.

### *Charging*

We acknowledge the work of National Grid in developing charging arrangements for offshore generators and the expectation of Ofgem / BERR that final proposals will be brought forward by the end of the year. That said, we remain concerned that the charging modification proposal being developed by National Grid is extremely complex and is likely to become more so given the parallel developments in the charging arrangements for "local" asset charging and in response to the Transmission Access Review.

We continue to believe that the uncertainty and instability of transmission network use of system charges are a significant obstacle to investment in new generation in GB.

### *Access and compensation*

The proposals in chapter 7 of the policy document appear to contradict those in chapter 2. In relation to performance incentives, paragraph 2.41 says:



*We consider it appropriate that any penalties incurred by OFTOs should be dealt with via a downward adjustment to their regulated income, which will feed through into reduced transmission charges. In practice, the reduction in charges would be shared between all users, although as offshore generators will be paying the majority of the charges that reflect offshore network usage, they will be the main beneficiaries of any such adjustment.*

In contrast, paragraph 7.35 says:

*We consider that an offshore generator should be entitled to compensation for lack of access if an OFTO fails to meet its annual performance target. We consider that this compensation should be no greater than the penalty imposed on the OFTO.*

So, on one hand, the policy document proposes socialisation of penalties for poor performance and, on the other, it is proposed that penalties are ring-fenced and paid to the affected generator. A clear statement of the policy intent in this area is, we believe, urgently required.

We have consistently argued that the charges for use of the GB transmission system should reflect a user's rights for access to that system. Users should not, as is currently the case, be required to pay for full access rights and then not be compensated in the event that the system is unavailable. A clear, non-discriminatory approach to charging and compensation is required.

We believe that a fundamental revision to the approach for charging for use of the GB transmission system is required that puts in place clear, simple and stable charging arrangements that are predictable over the lifetime of a generation asset. The charging framework should take account of compensation arrangements in the event of loss of access: either all users should be charged the same and all receive compensation or users with a lower standard of connection should pay lower charges in lieu of receiving compensation.

*The mechanism for compensation arrangements for offshore generators should be defined in the CUSC.*

We agree. This is currently the case with the existing 'CAP048' arrangements which, it is our understanding, will also cover offshore generators. Under the current arrangements for onshore generators with a design variation, exclusions from the right to interruption payments are set out in clause 10 of the bilateral connection agreement.

*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 CUSC.*

As we describe above, we are not clear what is intended here. As transmission asset owners are not signatories to the CUSC, it would clearly be inappropriate to place obligations on transmission asset owners in the CUSC.

Penalties for poor performance and the revenue implications should be set out in the licence. If the form of the penalty is to be a payment from the offshore transmission asset owner to the System Operator that the System Operator then passes through to user(s), then this should be

set out in the licence and treatment of this payment should be set out in the System Operator's licence.

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

We agree.