

Introduction and Summary

SP Energy Networks welcomes the opportunity to comment on the issues raised by the above paper. These comments should be read in conjunction with our 'Headline Comments' sent on 4 July 2008.

We welcome the significant progress that has been made in developing the regulatory regime for offshore transmission. We look forward to the consultation on tender regulations, as these will also be a key aspect of the framework.

We continue to have some significant concerns over the detailed working of these arrangements, including the following points in particular:

1. *Adjustments to the Revenue Stream*

We remain concerned about how adjustments to an OFTO's revenue stream, in respect of unforeseen events, will be managed during the lifetime of the licence. There is little real experience of constructing and operating offshore transmission assets and a clear mechanism for dealing with, in particular 'unknown unknowns', is essential for an OFTO to be able to manage its mitigation measures.

2. *Incentives*

Penalties of up to 10% of annual revenue look to us to be particularly onerous when considered against the lack of experience in constructing and operating transmission assets offshore. It is also not clear how a 'permit' system will operate; however consideration should be given to a mechanism that accounts for major faults and has a process to deal with exceptional events.

3. *The Connection and Tender Process*

Although more information is emerging on the form of the tender documentation, (and we note that the consultation on tender regulations is due by the end of July), a clear understanding of how the process will be administered is essential. Allowing adequate time for potential OFTOs to prepare robust bids is essential to the success of the regime and to ensure that the revenue streams offer value to all stakeholders. We would also consider that a mechanism that allows bidders to recover costs associated with bidding would ensure that bidders are able to propose robust and innovative solutions.

The timing of seabed surveys will affect bid costs (and uncertainties), careful consideration is required to achieve the most effective use of these surveys.

We also believe that further consideration should be given to allowing for flexibility post-preferred bidder appointment, to enable the preferred bidder to firm the details of the bid, and then for Ofgem to allow demonstrable revisions to the original tendered revenue stream. This could offer the most efficient price whilst minimizing the tender period. In the absence of such a provision, bidders will be likely to build in additional 'headroom' in their bids, so implying higher charges to users.

4. *The role of NGET*

We note the statement in the paper that 'NGET is engaging in bi-lateral meetings with transitional projects.' It is not yet clear to us that potential conflicts of interest arising from the GBSO and OFTO roles of NGET and affiliates in bidding for, or operating offshore transmission assets have been fully addressed. It is important that arrangements are established to ensure that other potential bidders receive adequate assurance in this regard.

5. *Decommissioning*

It is essential that the price control mechanism makes allowance for the OFTO to recover efficient decommissioning costs that will only become clear as the project enters the later phases.

Our comments on the detailed questions in the paper are set out below.

Chapter 2 Design of the Regulatory Regime

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

We can see the case for ‘unknown unknowns’ to be dealt with on a case-by-case basis. It is true that to some extent licensees could mitigate or insure some of the risks in this category. However, bidders would need to fully understand their exposure to such risks (for example, prolonged severe weather or terrorism) in constructing their bids, including the criteria that Ofgem would use in assessing claims for cost recovery.

For ‘known unknowns’ we agree that pre-defined adjustments should generally be avoided. In certain cases, such as decommissioning costs, where there is only limited knowledge available in relation to offshore transmission assets, we would expect pass through of costs incurred subject to an agreed efficiency test.

Incremental capacity – updated position

The 20% threshold would appear reasonable value, however we would seek further clarity on the scenarios. As we understand it, the OFTO will be required to absorb financing costs of incremental investment due to capacity increases required during the construction period; this would represent significant risk to the OFTO. More detail is needed on the arrangements for adjustments to allowed OFTO revenue as a result of incremental investment required post licence award.

Appropriate structure and level of OFTO performance incentives

We agree that a losses incentive is not appropriate.

The proposal for a delivery incentive does not appear to take into account that the OFTO itself will have every incentive to complete works as quickly as possible in order to secure the full benefit of the revenue stream. It is difficult to understand why incentive/penalty arrangements here should differ from those applicable onshore.

The proposal for a one-way availability incentive (penalty) of up to 10% of annual allowed revenue remains a significant concern, particularly given the lack of experience with offshore transmission. It is not clear whether the proposed incentive takes any account of wind availability or the benefits of planning maintenance outages during periods of low export. We acknowledge that the incentives will be considered on a project-by-project basis and would consider that a negotiation between Ofgem, the developer and the OFTO could be an effective way to determine an appropriate level. However we are concerned that onerous penalties are likely to have an impact on the price of the project, or at worst could act to discourage participants.

Chapter 3 -Tender Process (including Transitional Arrangements)

Proposed pre-conditions for the enduring tender process

We agree that an accepted CUSC offer from the GBSO should be a precondition in addition to lease arrangements with the Crown Estate (we assume in the latter case it is an Agreement to Lease that is referred to). In the case of transitional projects we are not clear why there is a reference to a “secured” rather than “agreed” offer from NGET.

Proposed approach for treating seabed surveys

Prospective OFTOs may need to provide additional ‘health warnings’ with their bids if reliant on a seabed survey carried out on behalf of the developer, although we agree that this could save time and expense. Seabed surveys undertaken during the tender process will have a significant impact on the time taken to complete the process to select the preferred bidder. Verification of survey information post preferred bidder stage, and the associated option to vary the revenue stream will lead to a more efficient process.

Proposed linkage between the tender process and the connection process

We would expect that as the OFTO's construction offer will have been assessed as part of the tender process, it will not also be exposed to the possibility of a reduction in allowed revenue as a result of a determination of the second stage connection offer to the developer.

Proposed approach for OFTOs to provide construction security

We are unclear as to the need for the OFTO to provide "... sufficient security to cover the costs of the construction works...[T]hat would be drawn down in the event that construction could not be completed by the OFTO." It is essential to understand the purpose of the security in order to comment on the appropriate level, in general the security should reduce as the construction progresses. A further consideration is if an OFTO were to default, what are the financial arrangements when a new OFTO is successful in taking over the project.

Proposed approach for preferred bidder to make to its construction offer through the STC process

In principle this is appropriate.

Chapter 5 - Licence Drafting

Does the licence drafting reflect our policy positions?

We broadly agree with the approach adopted in relation to standard licence conditions. However, we think that the Credit Rating requirement for OFTOs should be the same as for onshore TOs, and that IDNOs are not an appropriate comparator here given the relative size and importance of offshore transmission projects. We are also unclear why one licence condition cannot cover the requirement on the GBSO to offer connections terms for both onshore and offshore projects.

We look forward to proposals for special licence conditions, in particular detailed arrangements for incentive and other adjustments to allowed revenue streams, as these will be a critical aspect of the enduring regime.

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

We look forward to the further consultation due in September.

Chapter 6 – Technical Rules and Industry Codes

Does the drafting in the annexed codes accurately reflect the policy positions?

There are extensive changes to a significant number of documents and, as an active participant of working groups we would expect our view to be captured within the code changes. In the timing of the consultation it is however difficult to review all of the changes and the associated interdependencies. We have listed below some areas where we feel that the codes require additional review:

Grid Code – We were surprised to see the changes to OC8 included new appendices OC8C and OC8D. As members of the Grid Code Safety Coordination Working Group we understood that modifications to OC8A and OC8B would capture the required changes to accommodate offshore transmission. We acknowledge the time constraints referred to Appendix 5 of the consultation however as this is a key safety issue it is essential that the right solution be achieved. We are keen to participate in a review of the recommendation in order to understand the reasoning behind the additional appendices before we make detailed comments.

STC - The modification to include Offshore Transmission Licensees as 'Relevant Transmission Licensees' leads to the possibility of onshore TOs not being directly represented on the GCRP. We believe that it is important for the Scottish TOs to be specifically represented at the GCRP. As we suggested when the drafting was first proposed, this could be resolved by either (i) increasing the

membership of the GCRP to retain the Scottish TO representation and also include OFTO/s, or (ii) modify the general conditions to ensure that there is one onshore TO and one offshore TO represented on the GCRP.

In terms of the operation of an OFTO's transmission system, the OFTO should have the opportunity select how transmission facilities are provided.

GBSQSS – We have concerns regarding the demand requirements as highlighted in the Appendix 5; the use of a diesel generator capable of energising the 33kV to provide network security would require careful consideration in terms of technical requirements and commercial implications.

In terms of the generation connection criteria, 7.8.3.1 seems to imply that, to comply with the requirement for planned outages, the 33kV busbars owned by the OFTO would need to be double busbars, we are sure that this is not the intention and would seek further clarification on this.

Chapter 7 – Transmission Charging, Access and Compensation

Mechanisms for compensation arrangements for offshore generators

We note the proposal for such arrangements to be set out in the CUSC. We remain highly concerned at the extent of the annual availability incentive proposed in relation to OFTOs.

In relation to CAP48 compensation payments, it is important to note that at present these are pass-through items in TO price control pending the development of a workable incentive arrangement. There is as yet no agreed methodology for allocating responsibility for fault outages between the SO and TO. There is also an issue of 'double jeopardy' for the OFTO in the event of both CAP48 payments and an availability incentive being in operation.

OFTO funding of compensation in relation to availability

Please see comments above on compensation arrangements. Subject to these we agree in principle with OFTO funding of compensation (if any) being set out in the STC.