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Re: Offshore Electricity Transmission: Consultation on the Enduring Regime

Dear Sam

Thank you for the opportunity to respond to this consultation on the enduring offshore transmission regime.

We would like to highlight three key issues that arise from the consultation document:

- i) enhanced flexibility within the enduring regime;
- ii) developer engagement; and
- iii) the OFTO availability incentive.

We consider each of these points and provide additional comments in relation to other points raised by Ofgem in the consultation below.

i) Enhanced flexibility within the enduring regime

The consultation reiterates the policy that the OFTO will design and construct the offshore transmission assets in the enduring regime. The consultation also sets out the areas and basis on which a developer may be able to recover certain economic and efficiently incurred pre-construction development costs prior to entering an OFTO tender. Ofgem considers that an OFTO can be appointed at either an early stage in the project or after a developer has completed its initial design and consented a connection solution, a late appointment of an OFTO. Although, we note, that in describing the late OFTO it is suggested that developers may want to appoint the OFTO at a later date "i.e. closer to the date at which they would hope to begin generating...".

The way that the enduring regime will apply will imply an inevitable and unavoidable delay in the construction process for some early enduring projects and the Crown Estate

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Round two and a half projects. This is because of the time taken to run a tender process to construct the offshore network and ensure the supply chain is in place, which then, thereafter, clearly has to be constructed. Such a delay will directly impact on the economics of these projects and may ultimately deter some of them from proceeding. We believe this delay could be avoided, as set out below.

Ofgem's proposal for the enduring regime also has the difficulty of appropriately incentivising the OFTO to construct the project to the original programme. If the project is delivered late, the offshore generator will suffer a substantial loss of profit. This risk must sit with someone but passing this risk fully on to the OFTO would result in a substantially higher cost of capital for the OFTO, and leaving it with the generator, who has no ability to manage or mitigate the risk, also seems unpalatable.

Our proposed solution is to provide offshore developers the option to design and construct the offshore transmission asset and, via a future tender, to transfer these assets to a winning OFTO provider. The benefits of this approach would be that (i) the developer, who is most affected by the risk of overrun to the construction programme, is able to manage this risk, and (ii) without a lengthy tender process offshore developers will be able to make quicker progress. E.ON believes that this proposal will not only help to promote the confidence of offshore wind farm investors in the enduring OFTO arrangements, but will also make it more likely that offshore developers would sanction the relevant investment and construction costs for consented offshore wind farm projects earlier than would otherwise be the case.

It would not be our intention that this should be an exclusive option, as the early and late approaches as described in the consultation would continue to be options for development under the enduring regime. The benefit of adding this additional flexibility is that it allows the market to discover the optimum solution for each individual project.

We note that there is no intention to change the OFTO of last resort arrangements, however, we would ask that if the additional flexibility we describe is to be introduced then it would provide further confidence in the enduring arrangements if this aspect was reconsidered.

ii) Developer engagement

Ofgem has to achieve a fine balance in meeting individual project requirements whilst ensuring that the final decision is the best outcome for the consumer. Clearly this is not on a cost basis alone. However, we are concerned that focus on the cost element, through variant bids, may not always accord with the developers requirements. In identifying variant bids Ofgem must ensure that if it is minded to consider these, it must achieve the

developers requirements as well as being in the best interest of the consumer.

Whilst Ofgem considers defining the basis on which a bidder can present variant bids, the process by which Ofgem consults with the developer on the options presented by bidders is not as well described. If Ofgem intends to revert to developers when considering variant bids, in order to improve certainty and the transparency of this to investors, it should consider and accept appropriate obligations to do so in the Tender Regulations.

It may be that the degree of developer engagement depends on when the developer seeks to commence a tender. With the early model, where there is perhaps relatively little developer information, other than the connection application, so that the level of engagement with the developer is limited. With the late model, where a developer has incurred a degree of pre-construction cost and perhaps consents a connection solution, the developer's tender specification will contain more prescriptive requirements for bidders, so the scope for variation may be less but equally more critical to the development. In turn our proposal whereby a developer constructs the offshore transmission asset and transfers it to the OFTO at the point the asset is commissioned, would necessitate a degree of developer engagement to agree appropriate terms for the transfer of the offshore transmission assets and the appropriate treatment of any potential OFTO risks.

In this regard the move to a standard Ofgem defined Sale and Purchase Agreement is only appropriate providing (i) that it is not at the expense of the developer's ability to negotiate terms which are acceptable to it and the bidders – as such any standard SPA would need to be a document agreed by the industry; and (ii) it is capable of being amended to be appropriate for an individual project. Smooth operation of the tender process is a welcome goal, but it cannot be at the expense of the ability of the counter-parties to complete the transaction.

We would encourage Ofgem to consider ways in which there can be direct discussions between bidders and developers in the case of late or very late appointment of the OFTO.

iii) The OFTO availability incentive

We continue to be concerned about the level of incentive on an OFTO to rectify in a timely manner faults and failure of its assets under the availability incentive. We appreciate that the regulatory approach is intended to promote a lower cost of capital, however, this has to be balanced against the importance of the OFTO's assets as the only route to market for the offshore generator. This is of particular significance given the lower level of redundancy prescribed in the SQSS for OFTO assets compared with onshore connections.

In order to ensure faster repair times and incentivised the OFTO to take all steps to rectify faults and failures, the 10% cap on its annual revenue should be removed. In this case the TNUoS charge revenue would not be received for the duration of the fault or failure. We recognise that this may result in a higher risk opportunity, however, in the cases where an OFTO will design and construct the offshore transmission assets this is likely to be measured as a more high risk activity in any case.

We welcome the prompt from Ofgem for National Grid to consider the issue of charging cashflows under the availability incentive, so that that the generator more directly receives the benefit of the reduction in the OFTO's annual revenue.

Other comments

With regard to Ofgem's consideration of a new obligation on developers to complete within a defined timeframe, this may not be practical to achieve, as in any event the developer's lead time will be dependent upon the OFTO's, which will not be known until the outcome of the tender process. The developer's timeframe, including its supply chain, then has to match up with the OFTO lead time, unless the developer has the option to design and build the offshore transmission assets itself.

We hope that you find our comments of use. If you would like to discuss any aspect of our response in further detail please do not hesitate to contact me.

Yours sincerely



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