

By email: offshore.enduring@ofgem.gov.uk

DONG Energy Power (UK) Ltd.

33 Grosvenor Place
Belgravia
London SW1X 7HY
United Kingdom

Tel +44 (0) 207 811 5200
Fax +44 (0) 207 811 5298

www.dongenergy.com
Company no. 49 84 787

Dear Megan,

20 February 2012

RE: Consultation on licence policy for future tenders

Your ref. 159/12
Our ref. 130220_OFTO Enduring
Licence

ebjoh@dongenergy.co.uk
Tel 02078115200

Thank you for the opportunity to comment on this consultation. DONG Energy is a leading energy company operating in Northern Europe and headquartered in Denmark. It is one of the most active offshore wind operators and investors in the United Kingdom. DONG Energy has participated in four completed transitional OFTO tenders with a combined value of nearly £300 million, has interests in three more projects due to complete under the transitional regime, and has five more projects in development that will fall under the enduring tender regime.

We welcome Ofgem's decision to improve the availability incentive mechanism, and support the preferred option of a capacity weighted incentive which we believe would reduce the risk of unavailability to generators. We believe there is some merit in further considering differentiating between planned and unplanned maintenance, and are happy to continue to cooperate with Ofgem to further improve the incentive.

We do believe there is an urgent need to clarify the arrangements for extending the 20 year licence period, and for Ofgem to set out the arrangements for how licence durations will apply to phased projects. Round 3 projects are many times the size of transitional projects, and uncertainty over whether a phase consisting of up to several hundred MW of capacity will have access to transmission assets with a full 20 year licence is a major concern for developers. We have raised this issue in the context of the offshore coordination workstream as well, and look forward to a timely decision by Ofgem.

Our responses to the detailed questions can be found below.

Yours sincerely,



Ebba Phillips John

Regulatory Affairs Advisor

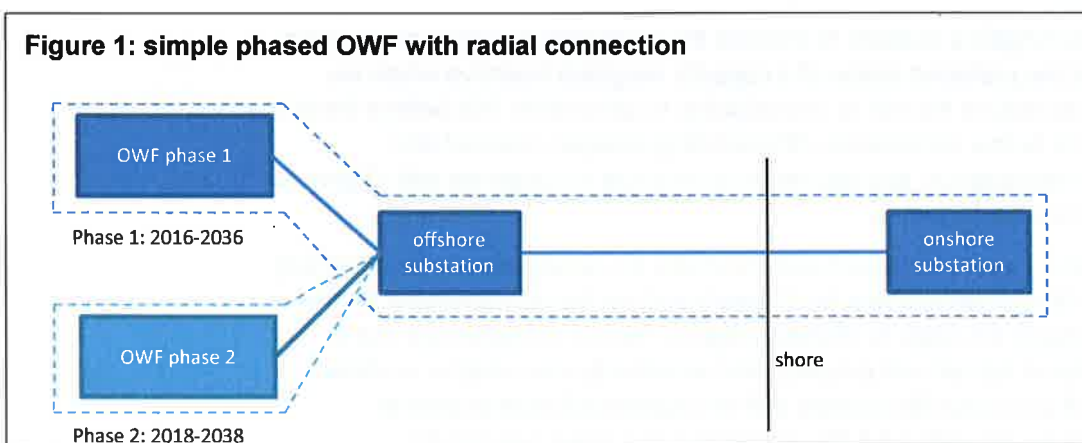
DONG Energy

Q2.1: Do you agree that the 20 year revenue term is appropriate for point to point systems?

As we have stated in previous consultation responses, we believe a 24 year revenue term would be more appropriate, as this is the lifetime we are expecting for our wind farms. As an example, DONG Energy's first (and the world's first) offshore wind farm, Vindeby, was constructed in Denmark in 1991. It is still running and producing electricity from 90% of the originally installed capacity 21 years later.

We disagree with Ofgem's decision to wait until the end of the initial revenue stream period to provide guidance on the process for ending or extending the revenue stream period. This is particularly important for coordinated projects (our concerns are repeated in our response to Ofgem's consultation 164/12), where a simple phased project with a radial ("point to point") connection would need certainty that later phases will have access to the network for the entirety of its productive life.

In Figure 1 below, the second phase of the radially connected wind farm would only have certainty of connection to shore for 18 out of 20 years under the current arrangements. Uncertainty over end-of licence arrangements and applications for even the simplest phased projects will have a detrimental impact on the ability of generators to take FID on such projects.



However, the needs of individual wind farms are likely to differ, and for this reason Ofgem should set out a range of options for end-of licence arrangements. In addition to the existing policy on OFTO-led decommissioning, Ofgem should at a minimum consider the arrangements for the following scenarios:

- Extension of licence for wind farm that will repower: some wind farms may choose to repower, and this could have implications for the transmission assets.
- Extension of licence for existing wind farm: an existing wind farm may wish to continue to generate for a limited period of time (e.g. 2-5 years), and would require an OFTO with a licence to cover that duration. The OFTO's revenue requirement would only need to cover its ongoing O&M costs.

The Generator should be able to initiate discussions with Ofgem around year 16-17 to explore options for licence extension for the OFTO assets, based on guidance and principles which need to be established now.

Q3.1: What do you think are the advantages and disadvantages of each refinancing policy option? Please explain why.

Our understanding is that OFTOs based their bids in the transitional rounds on the assumption that they would be able to obtain a portfolio of projects and be able to refinance the entire portfolio. This would have been built into their TRS bid, and as such the benefit to consumers of refinancing would already have been realised.

We also note that at the time of the transitional tenders the terms for bank finance were relatively good for the OFTOs, with some able to finance their purchase on very long terms (up to 19.5 years). In these cases refinancing would be less likely to occur in the near term as the terms for bank finance have worsened recently. Due to the worsening of the terms of bank finance, OFTOs planning to enter tenders in the near future may be unable to get finance for the full licence period, and will have to refinance for example after 10 years. The benefits of a future refinancing exercise may thus be included in the bidding OFTO's base case, rather than being treated as a potential future upside.

The conclusions of the Public Accounts Committee's report on the OFTO regime strongly supported the introduction of a refinancing gain share mechanism, and we believe that there is likely to be more merit in considering this for OFTO build projects. We understand that there is an increased focus on refinancing gain share mechanisms across Government following the experience gained from Private Finance Initiatives, and we think it is important to note that while refinancing mechanisms may be suitable in some areas, they are less so in others. For example, we do not believe refinancing gain share mechanisms are appropriate for the Contracts for Difference mechanism. Here, the contract will be signed and the strike price specified at the time of FID, whereas the developer will not finalise the financing of the project until after FID has been taken – potentially with a lag of one or two years. The risk associated with the timing of financing the project is solely borne by the developer, and it would not be appropriate for the Government to seek to change the level of support depending on the outcome of the financing.

Q3.2: Are there other refinancing options that you think we should also consider?

No comment.

Q3.3: What are the benefits of OFTOs coming under common ownership and what are the associated issues that Ofgem should consider? To what extent should we capture any gains from OFTOs coming under common ownership?

There could be benefits of OFTO mergers, in that a larger OFTO could realise synergies from serving a larger number of projects. For example, as a developer with a large portfolio of offshore wind farms, DONG Energy is able to hold spare parts and vessel contracts that enable us to quickly respond to technical issues on our wind farms – a large OFTO would be able to realise similar synergies. For example, we are aware that Transmission Capital Partners has secured a control room in Scotland with 24/7 abilities for long term purposes, and the O&M for the Ormonde OFTO is currently run from there.

However, as there are only a limited number of OFTOs currently awarded licences, OFTO mergers could have detrimental impact on competition and push up the cost to the consumer in future tenders. In the case of OFTO mergers Ofgem would need to do a careful assessment of the impact on market power, as the current competitive tender approach would not be suitable for a market with one dominant OFTO.

Q5.1: Do you agree with our proposal to introduce the capacity weighting mechanism to the availability incentive mechanism?

DONG Energy supports this improvement to the existing availability incentive mechanism, and welcome Ofgem's efforts in finding an improvement to the current mechanism.

However, we note that the strength of the mechanism will to some extent depend on the design of the offshore transmission assets. If the wind farm is connected through multiple cables and offshore substations (e.g. London Array with two offshore substations and four export cables), it would be possible for the OFTO to arrange an outage that has less impact on the generator's ability to export compared to a wind farm with a single cable and offshore platform.

Q5.2 Do you agree with our proposal not to introduce a penalty differential between planned and unplanned outages to the availability incentive mechanism at this time?

We do not agree with this proposal. Our practical experience as the O&M contractor for the OFTO assets of our operational wind farms suggest that the OFTOs are concerned with minimising the number of outages taken, including ones for planned maintenance. In addition, a stronger penalty for unplanned outages could not only incentivise a better strategy for planned outages, but could also incentivise the OFTO to take mitigating measures, such as buying spare parts and contracting in advance for services that would reduce the downtime in the case of an unplanned outage.

We disagree that it would be difficult to differentiate between planned and unplanned outages, and that reporting requirements would be onerous. Planned outages for maintenance are already clearly flagged through the TOGA process whereby the OFTO must submit outage plans many months in

advance. The equipment and purpose of the maintenance is clearly marked in these registrations. When a fault occurs on the OFTO assets the OFTO is obliged to submit a Significant Incident Report detailing what has occurred and when and how they expect to remedy the fault. We see these two components as preventing an attempt to pass off an unplanned outage as a planned outage.

Q5.3 Are there any further issues that you feel we should consider as part of our enhancements to the availability incentive? If so, why?

We believe that there continues to be an interdependency between the availability incentive mechanism and the cost assessment process, in that costs associated with low availability could be mitigated through increased CAPEX or OPEX spend. While not strictly part of the availability incentive mechanism, Ofgem should consider this trade off in its development of cost assessment guidance later in the year.

Q5.4 Going forward do you think that the use of TEC for the maximum availability will remain appropriate? If not, what project designs might TEC not be appropriate for and what alternative would there be?

There are projects under the transitional regime where the availability is not based on TEC, for example for the OFTO assets for Walney 1 and 2. For these projects the OFTO have specified in their TOCA that the cable is only capable of operating at its full capacity for 1 week. As a result their availability incentive uses the maximum transmission system availability calculated as: two periods of 168 hours in each month at the Enhanced Rating (182 MW) and the balance of hours in the month at the Normal Rating (155 MW). This equates to around 168MW, less than the TEC of 184MW.

We believe Ofgem should keep a flexible approach to ensure the availability incentive mechanism accurately reflects the project specific assets, including for more complicated coordinated assets.

Q5.5 Do you agree with our intention to remove the ICUA term and only use the ACA cost assessment term to calculate the remuneration required for providing additional capacity?

The opportunity to add incremental capacity could be a relatively simple way to connect projects built in phases, so it is important that the remuneration available to OFTOs offering increased capacity is appropriate. We agree with Ofgem's assessment that the ACA cost assessment term should replace the ICUA term.

If additional capacity is added through this mechanism, we want to emphasise the need for Ofgem to be able to adjust the licence duration for any additional wind farm capacity that connects. A wind farm that connects in several phases through additional transmission asset capacity provided through the ICA provisions should be able to rely on having access to transmission assets with a full 20 year licence period.

Q5.6 Do you agree with our intention to not introduce greater flexibility in relation to remuneration for incremental capacity at this time?

We believe that Ofgem should consider adding more flexibility. However, the more important aspects of this policy is to consider the inclusion of a generator build option, and the links with the policy on anticipatory investment, as set out below.

Q5.7 Do you believe that adding an absolute threshold for incremental capacity would be beneficial? If so, what should the value of the threshold be?

We do not think Ofgem have adequately considered the benefits of projects having a single OFTO when looking at the potential costs from excluding incremental capacity from a tender exercise. The risk of ending up with several OFTOs and the implications that would have for availability incentives, interface agreements, and so on would make phasing through the incremental capacity incentive an unlikely choice for generators.

We also consider it unlikely that generators will choose to add small amounts of additional capacity, as the wind farm is likely to be optimised in terms of layout and technology choice. Additional capacity is likely to come from phased projects, where the very reason for phasing is likely to be due to the size and cost of the whole project.

For this reason, the absolute cap should be £300 million pounds, as we consider it unlikely that generators will add small amounts (and with large projects phases will be larger).

Q5.8 What are the benefits, drawbacks, risks and considerations in adapting the incremental capacity mechanism to allow Generator build of subsequent phases?

As set out in the consultation document, there are significant barriers for an OFTO to be able to deliver incremental capacity in a timely manner. We believe that extending the incremental capacity addition rules to include a generator build option is appropriate. Due to the difficulties of adding additional capacity to existing assets, to be able to add any meaningful capacity would require the generator to take a decision on e.g. the design of the offshore platform to accommodate spare capacity. We believe the most likely use for adding incremental capacity will be for generators choosing to build large offshore wind farms in phases, and assuming that the cap is not too restrictive it would allow generators to take separate FIDs on phases without running the risk of ending up with different OFTOs through separate tender exercises.

Under generator build, the incremental capacity option becomes closely linked with the policy decisions taken on anticipatory investment in the offshore coordination work stream, and the ability of developers to take forward anticipatory investment in oversized assets with confidence. This is further addressed in our response to consultation 164/12 on coordinated offshore networks.