

Megan Smith
Offshore Enduring
9 Millbank
London
SW1P 3GE

22 February 2013

Dear Megan

Offshore Electricity Transmission: Consultation on licence policy for future tenders

EDF Energy is one of the UK's largest energy companies with activities throughout the energy chain. Our interests include nuclear, coal and gas-fired electricity generation, renewables, and energy supply to end users. We have over five million electricity and gas customer accounts in the UK, including residential and business users.

Our key comments are as follows:

- EDF Energy agrees that the 20 year revenue term is still appropriate for point to point systems and would help minimise any potential asset stranding.
- It may be difficult for all potential refinancing gains to be accurately reflected in the initial tender bid given the length of the revenue term. Therefore, the option of a gain share refinancing incentive mechanism may be more effective towards securing the benefits from refinancing for consumers.
- We believe revenues should be increased in line with inflation to protect the OFTO, but they should be linked to a more appropriate index which more accurately reflects their costs.
- It is questionable whether RPI is the correct measure of inflation to use, since not all OFTO costs will be linked to RPI.
- We agree that the capacity weighting mechanism should be introduced to the availability incentive mechanism to ensure that any outages will cause the minimum possible disruption to power exports.
- We support the initiative of adopting the incremental capacity mechanism to allow generator build of subsequent phases, as there are clear benefits to allowing the developer to build required extra capacity as and when required.

Our detailed responses are set out in the attachment to this letter. Should you wish to discuss any of the issues raised in our response or have any queries, please contact Mark Cox on 07875115499, or myself.

I confirm that this letter and its attachment may be published on Ofgem's website.

Yours sincerely,

A handwritten signature in black ink, appearing to read "D. Linford".

Denis Linford
Corporate Policy and Regulation Director

Attachment

Offshore Electricity Transmission: Consultation on licence policy for future tenders

EDF Energy's response to your questions

Chapter 2: Revenue framework

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

EDF Energy agrees that the 20 year revenue term is still appropriate for point to point systems and would help minimise any potential asset stranding. This is on the basis of the current level of information regarding expected longevity of the wind park generation assets, namely that it is uncertain that they will be operational beyond 20 years. A 20 year period also aligns with the Renewable Obligation and Contract for Difference support mechanisms.

Chapter 3: Refinancing

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

Option 1: Retaining the transitional regime policy

We agree that the advantage of retaining the transitional regime policy is that it is simple, tried and tested and minimises regulatory costs. This mechanism should support cost efficiencies being factored into the tender process because it enables bidders to submit any predicted refinancing gains into their tender bid.

By effectively forcing the investor to fix the level of expected refinancing gain from the outset, there is the risk that the actual refinancing gain will be either greater or less than the expected figure potentially resulting a windfall gain or loss for the investor. In either scenario this uncertainty could be considered a disadvantage to the investor. However, assuming these benefits are reflected in participants' bids then the refinancing benefits will be received in any eventuality, either in the initial bid or later through claw back. Given the length of time involved it may be difficult for all potential refinancing gains to be accurately reflected in the initial bid, and so a gain share mechanism is likely to be more effective towards securing gains for consumers.

Option 2: Implementing a gain share mechanism

An advantage to consumers could be achieved via the actual, rather than anticipated, refinancing gains, however, this there is the risk that this may be greater or less than the projected refinancing gains and therefore could also be considered as a disadvantage depending on the outcome.

A disadvantage of the gain share mechanism may arise from the fact that an initial bid is likely be higher as it will not include any element of refinancing gain. This would increase uncertainty as the level of revenue stream by the OFTO will be variable and will also require increase regulatory oversight and associated costs, although this is likely to be limited as the scale of these projects becomes much more material.

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

EDF Energy believes the available refinancing policy options have been identified.

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?

EDF Energy assumes common ownership means joint ownership of offshore transmission assets. On this basis the main benefit from a change in ownership in favour of consolidated entities is likely to be their ability to access funds, at a lower rate, and hence obtain some potential financial savings. These benefits will not be shared with consumers, given that revenues are fixed, therefore we believe that, in a similar context to refinancing gains, there should be a regulatory mechanism to ensure consumers gain some of the benefits that may be achieved through consolidation. This becomes particularly relevant as the size of these OFTO assets increase in value such as that expected under the round 3.

Chapter 4: Indexation

Q4.1 What do you think are the advantages and disadvantages of each indexation policy option? Please explain why.

- **Retain the transitional regime policy of 100% indexation – under this option 100% of allowed revenues increase with RPI.**

We believe revenues should be increased to protect the OFTO, but they should be linked to a more appropriate inflater which more accurately reflects their costs.

An advantage of this regime, from an OFTO perspective, is that it may provide security of income in real terms which could be expected to keep pace with any increases in the costs of running the network.

A disadvantage, from a consumer perspective, is that not all OFTO costs will be linked to RPI, for example, debt costs may be fixed, or floating and linked to the Bank of England base rate. It would not be appropriate to link these costs to RPI, as it would lead to basis risk. It is also questionable whether RPI is the correct inflation measure to use as an index; a construction industry measure of inflation may be more appropriate.

In addition RPI is currently growing faster than real incomes and welfare benefit payments, meaning that the burden on the consumer will increase with the passage of time. Overall, it is questionable whether RPI is the correct measure of inflation to use, as it includes council tax and housing costs which are clearly not relevant for an OFTO.

- **Allow biddable indexation – under this option bidders would be allowed to decide what proportion of their revenue they would like to increase with RPI.**

The advantage of this approach is that it would allow bidders to tailor their proposals accordingly to only their costs which are linked to inflation, and therefore will increase in line with inflation. This will enable them to closely tailor their income stream to their liabilities.

The main disadvantage will be that each proposal is likely to contain varying amounts of inflation linked payments making it more difficult compare the real cost of each bid.

- **Have a fixed proportion of revenue being indexed – under this option Ofgem would determine what proportion of allowed revenue increases with RPI.**

This approach would enable revenues to be more closely tailored to increases in costs of running the network. This could provide some additional security in revenues for the OFTOs in the face of potential cost increases.

A disadvantage of this approach is that it only applies on a notional proposal therefore in reality it's unlikely to precisely match the requirements of individual projects. In practical terms however, this may be the most attractive option as it provides comparability whilst only indexing an appropriate or suitable proportion of revenues.

Q4.2 Are there other indexation policy options that you think we should also consider?

We believe the options discussed cover the full range of possibilities, namely from bidder specific indexation amounts to a fixed notional one.

Chapter 5: Revenue incentives

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

We agree that the capacity weighting mechanism should be introduced to the availability incentive mechanism. We believe that it will provide the appropriate incentives to ensure that any outages will cause the minimum possible disruption to power exports, especially wind farms' likely generation profiles and taking account of the existing seasonal weighting mechanism.

We believe that the bonus mechanism should not be adopted, as it would create significant extra complexity with few corresponding benefits.

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 believe that there is sufficient justification to introduce a penalty differential between planned and unplanned outages at this time. OFTOs are already incentivised to minimise unplanned outages under the current mechanism, together with the existing seasonal weighting mechanism which provides for more substantial penalties in the higher demand winter months.

Therefore, we believe the additional complexity that would be created by this mechanism would not be compensated for by any benefits arising from its implementation.

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?

As OFTO availability performance has been high to date, it does not seem appropriate to seek to change the penalty cap levels, as they appear to be providing adequate incentives to ensure target availability is met. This may need to be addressed in the future should this situation change.

We believe it is also important to recognise there is a difference in regard to the level of impact associated with an unplanned outage vs planned outages on generators themselves.

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?

We believe that it may be more appropriate to base a project's maximum availability on the cable's maximum rated capacity, as a situation may develop where in the future where the generator is unable, in practice, to provide this level of availability due to cable constraints. At this point we believe consideration should be given to the use of the cable's maximum rated capacity, assuming that this is the factor which is limiting the availability of power exports to the wider grid.

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?

EDF Energy agrees that the ACA tool seems to be the most appropriate mechanism for measuring the costs of provision of the extra capacity. It is able to encompass all situations, by requiring the OFTO to provide the costs of providing the relevant extra capacity, whether it is for a major or more minor project.

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

EDF Energy broadly agrees and suggests that this question be revisited should the nature of phased projects alter significantly.

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?

Given that the size, and hence asset values of projects is tending to increase at the current time, we believe that it would be appropriate to set an absolute value for the incremental threshold in conjunction with the existing 20% limit. This will then ensure that the administrative costs of undertaking a competitive tender are always exceeded and allow more project extensions to be competed. However, we note our previous comments on coordination work stream that cost thresholds should not be the only determinant of whether subsequent project phases are tendered. There may be very real practical issues that would make multiple OFTOs ineffective.

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

We support the initiative of adopting the incremental capacity mechanism to allow generator build of subsequent phases as there are clear benefits to allowing the developer to build required extra capacity as and when required. We believe the developer should feel confident that its operations will not be delayed by the inaction of a third party or the competitive tender process itself. In this context and similar to our response to Q5.9, there may be occasions where it not always appropriate or practical to have multiple OFTOs in place once these assets are completed.

Chapter 6: Next steps and interdependencies

Q6.1 What further areas relating to your planned or potential future projects do you think that Ofgem should consider in order to help facilitate the efficient delivery of the OFTO build model?

No comment

Q6.2 Do you have any comments on the relevance of changes to the RIIO licence on the OFTO licence?

No comment

EDF Energy
February 2013