

## Regulation and Policy

Megan Smith  
Offshore Enduring  
020 7901 7091  
Offshore.Enduring@ofgem.gov.uk

Name Diana Chklar  
Phone 01793 474859  
E-Mail Diana.Chklar@rwe.com

22 February 2013

## Offshore Electricity Transmission: Consultation on licence policy for future tenders

Dear Megan,

Thank you for the opportunity to comment on your consultation in relation to licence policy for future tenders. This response is provided on behalf of RWE Renewables Limited a fully owned subsidiary of RWE Innogy GmbH.

We remain supportive of the OFTO regime and we welcome Ofgem's focus on further developing the generator build model. We believe that it is vitally important that the enduring offshore transmission regime is enhanced to meet the needs of larger and more complex offshore projects in the most efficient and flexible way. However, we believe that further changes should not undermine the competitive principals which underpin the regime and that Ofgem should ensure that the regime offers as much long term regulatory stability as possible. Consequently, we welcome some of the proposals set out in this consultation but have concerns that other proposals may increase regulatory risk and uncertainty.

One of the issues that we feel Ofgem should focus on as a priority is ensuring that appropriate arrangements are put in place to facilitate the connection of phased projects. We are very concerned that the existing regulatory framework does not provide sufficient flexibility for phased generator build projects.

Over the past few years, the industry has spent a lot of time developing and implementing the competitive OFTO regime. In this consultation, we are also concerned that Ofgem is looking undermine some of the key components of the regulatory framework by seeking to increase retrospective regulatory intervention. Ofgem has previously stated that competition for transmission licences has saved consumers £290M. However, some of the proposals contained in this document are likely to increase risks to developers and also to OFTOs. We believe that additional risk is likely to increase the cost of capital which in turn is likely to offset any savings identified through further regulatory intervention. If Ofgem intends to continue operating a competitive offshore transmission regime rather than a fully regulated offshore transmission network then we believe it should avoid excessive ex-post regulation and rely on competition law principals.

We recognise some of the issues raised by the National Audit Office in its report

### RWE npower renewables

Auckland House  
Lydiard Fields  
Great Western Way  
Swindon  
Wiltshire SN5 8ZT  
T +44 (0)8456 720 090  
F +44 (0)1793 474 841  
I www.npower-renewables.com

Registered office:  
RWE Npower Renewables Limited  
Auckland House  
Lydiard Fields  
Great Western Way  
Swindon  
Wiltshire SN5 8ZT

Registered in England  
and Wales no. 2550622

...

into the offshore transmission regime<sup>1</sup> particularly in relation to OFTO incentivisation and we welcome Ofgem's proposal to address this issue by introducing a capacity weighting incentive. We agree that the availability incentive is currently overly generous towards OFTOs but we do not agree with the NAO report's conclusion on this issue. It is not correct to say that the generator is protected from reductions in the usage of the offshore assets. Generators are required to pay for their stated TEC capacity irrespective of whether they are able to use it. If the transmission line is unavailable, generators cannot generate power and are therefore unable to recover the cost of the windfarm. It should be noted that the risk of not being able to recover the cost of the offshore windfarm is proportionally much greater than any ongoing exposure that the consumer may face in relation to the transmission assets.

The National Audit Office report refers to the private finance initiative as a means of comparison with the offshore transmission regime. However, as noted in the NAO report there are considerable differences between the two regimes, particularly in relation to the upfront and ongoing risk faced by the developer. Under the OFTO regime, it is the generator who finances and bears the upfront construction risks. Consumers are only exposed to any risk once the project becomes operational (because of the guaranteed OFTO revenue stream). Therefore, because the consumer is not exposed to the same level of risk, it does not seem appropriate to apply the same regulatory framework to the offshore transmission regime.

Please do not hesitate to contact me if you require any further information in relation to our response.

Yours sincerely

Diana Chklar  
Grid Regulation Manager  
RWE npower renewables

---

<sup>1</sup> [http://www.nao.org.uk/publications/1213/offshore\\_electricity.aspx](http://www.nao.org.uk/publications/1213/offshore_electricity.aspx)

## **RWE responses to individual questions**

### **Chapter 2: Revenue Framework**

#### **Question 2.1: Do you agree that the 20 year revenue term is still appropriate for point to point systems?**

Generally, we believe that the local assets should be linked to the lifetime of the Windfarm and we believe that the current 20 year revenue stream contained in the OFTO licence is appropriate. However, we also believe that it is important that offshore transmission licences remain flexible and can be extended where necessary in order to maximise the life of the windfarms.

Shared or coordinated assets may require a longer lifespan from the outset in order to reflect varying life expectancy of different underlying assets.

### **Coordinated network development**

#### **Chapter 3: Refinancing**

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

We do not believe that it is necessary to introduce refinancing gains for generator build projects. This mechanism is typically used in PFI contracts to claw back significant refinancing gains when new financing arrangements are made to reflect reduced risk post construction. For a generator build project, this type of refinancing gain would not be applicable because the OFTO would only put financing arrangements in place post completion of the offshore transmission assets. Therefore, this type of regulatory intervention is only likely to increase the upfront cost of debt.

However, if such a mechanism were to be introduced, it is unclear to us from the consultation document how the mechanism would work in practice. We believe that any refinancing gain identified should result in a reduced TNUoS cost to the developer. Otherwise, the developer would be paying higher TNUoS than the allowable revenue identified by Ofgem which would result in economic inefficiency. If the refinancing gain were passed back to the developer, it could help to lower the costs of offshore wind and to consumers in the long term.

However, as stated above, it is most likely that the OFTO would be disincentivised to find innovative financing solutions in the first place, if it had to pass any refinancing gains back through the regulatory process.

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

We do not believe that any refinancing options are appropriate for generator build projects for the reasons set out above. However, if OFTOs were to take on any type of construction risk, we believe that it would be appropriate to consider some type of clawback mechanism for any significant refinancing gains.

##### **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?**

We are concerned that allowing OFTOs to come under common ownership post licence award could result in increased risk to developers if they are exposed to new operational risks as a result of changes to the arrangements for the operations and maintenance of the offshore transmission assets. Ofgem should ensure that the OFTO licence obligations oblige the new OFTO to offer the same level of service at no increased operational risk to the developer as a result of the licence transfer.

However, if some form of common ownership were permitted at the outset of the appointment of additional phases in a phased project, this could help to prevent the difficulties posed by inter OFTO relationships for these projects. In such instances, Ofgem could assess any gains from the OFTO coming under common ownership at the outset of the additional licence award.

**Chapter 4: Indexation**

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

We believe that there are benefits in allowing the potential OFTOs to bid on the proportion of their revenue to be indexed and the applicable indexation method. It is likely this process would be more efficient than allowing Ofgem to decide on the indexation mix in advance of the tender process.

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

No response

**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 with this proposal and believe that it will improve the current availability incentive. We also agree that the seasonal weighting mechanism should be maintained especially where this is sharpened when implemented alongside the capacity weighting mechanism.

**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 believe that there should be a differentiation in the incentive mechanism between planned and unplanned outages.

**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 the OFTO should be further incentivised to work more closely with the generator and this could be done by using National Grid forecasting data. This data could be used to calculate actual losses on the system during times of outage and the availability incentive adjusted accordingly.

We disagree with the decision to abandon the previously proposed bonus mechanism. We would welcome capacity weighting mechanism but we believe that it should be implemented alongside other measures to further incentivise the OFTO.

**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?**

At present, we believe that TEC should continue to be used for calculating maximum availability. It may be appropriate to consider more flexible arrangements in future although we note the potential impact of additional risk to the OFTO should be considered.

**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?**

We agree that there should be some flexibility applied to OFTO licences. However, we believe that this issue should be addressed by enabling a single OFTO to take on subsequent phases of a project that have been constructed by a developer. A single licence would be awarded in this instance with the costs for subsequent phases either indexed or allowable as pass through costs.

**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 this mechanism should be used to allow single OFTOs to take charge of a phased project in its entirety.

**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?**

No we believe that the regime should remain as flexible as possible in order to meet the needs of future projects and to facilitate innovation.

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

We believe that developers should be permitted to build subsequent phases of a multi-phased project. It is highly unlikely that the 20% additional capacity threshold will be sufficient to do this. Our preference would be for Ofgem to design a process which enables a single OFTO to be licensed for an entire phased project. Our initial thinking is that we could facilitate this process by providing as much information as possible in relation to later phases which should enable potential OFTOs to bid on more than one phase at a time. Perhaps some form of indexation could be applied to certain costs contained within the bids with other costs such as changes in technology allowed as pass through costs.

We recognise that there are a number of issues with this approach and we believe that this issue needs to be considered in more detail as a matter of urgency. This issue could lead to difficulties for a Generator that has not settled on a final TEC capacity for later phases at the time that the OFTO is appointed.

Consequently, if a 2 phase project is awarded to a single OFTO before the construction of the 2nd phase then the developer may be exposed to significant additional risks.

**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 response

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

No response