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Offshore Electricity Transmission: Consultation on licence policy for future tenders

Transmission Capital Partners is the leading offshore transmission owner in the UK and we welcome the opportunity to contribute to the further development of licence policy for OFTO future tenders.

We understand the need to ensure that the revenue mechanism for OFTOs continues to provide the correct balance between attractiveness to investors and reducing costs in order to provide best value to consumers. We are pleased to see that Ofgem has adopted a well balanced and evidence based approach to the relevant issues and we set out our views on the specific questions raised in the attached annex.

We also note that the licence may need to develop in certain areas as it gets applied to new offshore transmission designs and types of asset. Again we set out our views on the specific questions raised in this area in the attached annex.

We are pleased to note that Ofgem is highlighting the flexibility available to offshore wind farm developers in the OFTO build and pursuing the introduction of competition into the delivery of onshore transmission. We expect the introduction of both of these to be beneficial to consumers and remain as always happy to provide whatever input would be helpful in these areas.

We would be happy for the views set out in this letter and its attachment to be made available via your website – any commercially confidential views we will send under separate cover.

If you wish to discuss any of our response please let me know.

Yours sincerely



Chris Veal
Director

Annex 1 – Specific question responses

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Chapter 2: Revenue framework
<i>Q2.1 Do you agree that the 20 year revenue term is still appropriate for point to point systems?</i>
<p>Yes, we do. There is sufficient technical confidence that the assets will have a life span of in excess of 20 years. A term beyond 20 years may lead to concern that the assets would require additional maintenance in later years and therefore, increase pressure on financeability. A 20 year term also allows for flexibility in finance solutions – it is a tenor which allows for long-term bank lending as well as capital markets funding. To increase beyond the 20-year term would likely further reduce the pool of banks able to fund with long-term commercial debt.</p> <p>At the expiry of the 20 year revenue term Ofgem still has the flexibility to discuss extending the term of a licence for an OFTO once it is known whether the connecting wind farm is going to be re-powered/re-planted.</p>
Chapter 3: Refinancing
<i>Q3.1 What do you think are the advantages and disadvantages of each refinancing policy option? Please explain why</i>
<p>Option 1 – Retaining the transitional regime policy</p> <p>We support the continuation of the transitional regime policy. While the consumer does not benefit to the extent that a bidder achieves a refinancing gain, in practice, gain share will often be largely offset by the real additional present costs of negotiating and implementing such arrangements plus any enhanced base case return required by investors because of such provision. To the extent Ofgem wants to continue to attract bank debt into the OFTO sector, it is paramount that banks are freely able to recycle their capital. If equity investors are not incentivised to refinance debt, banks are aware that they are unlikely to achieve their desired recycling of capital and their debt will be priced accordingly. Full flexibility in possible financing solutions will always attract the lowest cost of capital and drive innovation.</p> <p>Option 2 – Implementing a gain share mechanism</p> <p>Gain share mechanisms are well understood by PFI investors where refinancing gain share provisions have long been a feature of standard contracts. While we do not believe that gain share mechanics would affect our appetite to invest, it would reduce the incentive to do the work involved in a refinancing. If forced to do refinancing benchmarking, an investor would seek to price such additional ongoing work to the detriment of the consumer. Additionally, gain share mechanics would seem to be an imbalance in circumstances where the authority is not proposing to take any refinancing risk to the extent an investor chooses a shorter (and better priced) debt solution.</p>
<i>Q3.2 Are there other refinancing policy options that you think we should also consider?</i>
No.
Chapter 5: Revenue incentives
<i>Q5.1 Do you agree with our proposal to introduce the capacity weighting</i>

<p><i>mechanism to the availability incentive mechanism?</i></p>
<p>We still have reservations about the capacity weighting mechanism as we do not consider that it will drive a change in OFTO behaviour (as the OFTO will generally only take out a circuit at a time anyway) and it will introduce additional complexity into an already complex availability incentive mechanism.</p>
<p>We do however understand the rationale behind it and if as Ofgem states the change in the algebra required is minimal then perhaps it will not be overly complex or burdensome. Ofgem should note though that it is not only the OFTO that needs to understand the availability incentive mechanism but it is also investors, providers of debt, insurance underwriters, O&M contractors etc. and so any additional complexity potentially has cost consequences and makes the investment less attractive to investors.</p>
<p><i>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?</i></p>
<p>We agree with Ofgem’s proposal not to introduce a penalty differential between planned and unplanned outages to the availability incentive mechanism at this time. We would note that:</p> <ul style="list-style-type: none"> - As planned outages are taken when the seasonal weighting factors are lowest but unplanned outages could happen at any time of year, there is already likely to be a higher penalty for unplanned outages than for planned outages; - Given the incentives already in place any additional weighting is very unlikely to drive any change in the OFTO behaviour in respect of planned maintenance or preparing for and reacting to unplanned maintenance; - Any additional weighting is likely to lead to further complexity in an already complex availability mechanism which is likely to cloud incentives; - Any additional weighting is likely to mean that the cap is reached sooner at which point the incentive actually reduces – given the expected duration of some unplanned outages this may actually have the opposite consequences to those intended. <p>We doubt whether a planned/unplanned differential would be beneficial in the future as we would expect the above factors to persist. However, it may be sensible for Ofgem to keep this under review as network designs develop and experience is gained.</p>
<p><i>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?</i></p>
<p>TCP has now closed four OFTO deals and will shortly be closing a fifth and has almost two years of operational experience on the earliest of the projects to close. We consider that the availability incentive is working very well and has prompted TCP to carry out several asset management activities in order to maximise the OFTO asset availability that were not already being undertaken by the previous owners (the offshore wind farm developers). We also consider that, following a considerable educational effort from us, the investor community, insurance underwriters and O&M contractors understand the availability incentive mechanism as currently drafted. We do not think that continuous change in this area is either warranted or beneficial. As such we believe any changes that are made should have material and well substantiated reasons driving them. We do not therefore see the need for any changes at this stage.</p>

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?

It is important to remember here that the OFTO is making its assets available for use by NETSO as the system operator, and NETSO can use the assets in accordance with the data set out in the Services Capability Statement (SCS - an annex to the TOCA). Essentially therefore the measure that should be used for the OFTO assets maximum availability is the capacity required in order to meet NETSO's requirements in complying with the Security and Quality of Supply Standards (SQSS) and this should match that set out in the SCS. This capacity may be affected by generator choice (i.e. where other users are not affected it may be more or less than would otherwise be required by the standards). The use of the lower of the TEC and the Normal Capability Limits for the maximum availability is the appropriate measure for radially connected offshore wind farms but a different measure would be required for other designs. The capability required to meet SQSS should be set out by NETSO during the tender process. Generally it should not be driven by what the assets can actually do but by the SQSS requirement.

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 current provisions around the ICUA and ACA cost terms would benefit from clarification. For example the ICUA term is applicable where additional capacity is requested but it is not clear:

- i) Whether the OFTO can elect for an ICUA adjustment instead of an ACA adjustment if a small amount of cost is required to provide the additional capacity - as otherwise there would be a perverse situation where additional capacity could be provided for say £100 and would lead to minimal additional revenue under the ACA term – as opposed to additional capacity being provided for zero cost leading to a significant revenue increase under the ICUA term;
- ii) Whether additional revenue due to an ICUA adjustment is removed if the additional capacity request is removed.

Removing the ICUA term would deal with this issue but does raise the issue of risk to the life of OFTO assets of running them at higher loads – whilst there is a clear route for the OFTO to decide on whether to take this risk through the ICUA term, and there is a natural hedge in the duration of this risk and the additional revenues received – there is not a clear position on what additional revenues the OFTO would have recourse to for taking this additional risk through the ACA term. We would welcome Ofgem's views on how this risk would be compensated.

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

We agree that greater flexibility should be kept under review as planned project timelines and designs evolve, as detail on the size, timing and location of transmission lines emerges, and as the willingness of generators to allow OFTO build becomes evident.

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 agree that the 20% limit should be kept for now but would also be open to an absolute value being set on a project-by-project basis (and made available during the tender). The certainty that this would provide to investors, particularly in large projects, is likely to reduce financing costs and/or keep the investment open to a

wider pool of investors.
<i>Q5.8 What are the benefits, drawbacks, risks and considerations in adapting the incremental capacity mechanism to allow Generator build of subsequent phases?</i>
<p>We do not consider that a generator should have the right to build incremental asset phases that fall under the incremental capacity threshold.</p> <p>We believe that it will be to the benefit of consumers that the OFTO build model is developed and can be seen to be attractive and deliver as soon as possible. One route to achieve this, albeit on a small scale, is to enable OFTOs to build the assets required under the incremental capacity incentive.</p> <p>Whilst risks for generators should be relatively low (these assets are unlikely to require major offshore works), we understand that under some circumstances they would be keen to construct the incremental assets. Under these circumstances we would expect that they would be willing to make an attractive offer to the licensee to carry out this procurement, construction and commissioning work.</p>
Chapter 6: Next steps and interdependencies
<i>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?</i>
<p>We understand that this question is aimed at offshore wind farm developers rather than OFTOs but we remain willing to consider all options that would facilitate developers opting for the OFTO-build model. We were pleased to hear that the workshop held on 23rd January that Ofgem is open to further suggestions relating to:</p> <ul style="list-style-type: none"> - Input into choice of OFTO - Liquidated Damages - Intervention if things go wrong - Engagement by the developer with the supply chain <p>We would assume that Ofgem will be mindful that if further flexibility is introduced it is done so in a way that does not unnecessarily discriminate against any particular OFTO or source of funding.</p> <p>We remain open to assist Ofgem with the development of any of these mechanisms and to give our view of how these would affect OFTO bidders.</p>
<i>Q6.2 Do you have any comments on the relevance of changes to the RIIO licence on the OFTO licence?</i>
No.

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