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Licensing Offshore Electricity Transmission – a joint Ofgem/DTI consultation

Dear John,

Centrica welcomes the opportunity to comment on the joint DTI/Ofgem consultation on Licensing Offshore Electricity Transmission. Please find below our comments on the questions raised in the consultation document and some further considerations.

The government's renewables obligation has the objective of delivering up to 20% of the UK's electricity needs from renewable sources by 2010. This objective can only be met through a concerted programme of renewable build across all near-market technologies, the most important of which is offshore wind.

Centrica welcomes government proposals to reform the RO through a banded mechanism, but we have always been clear that this is only one part of the solution. An effective RO can only be achieved if the planning consent and grid connection issues are addressed in tandem with the funding mechanism. In relation to offshore wind, grid connection costs must be reduced if the technology is to reach maturity and government is to reach its targets.

Centrica, through its retail division British Gas, is a major supplier of electricity and consequently has a significant Renewables Obligation. The company has announced its intention to invest £750 million in renewable generation over a five year period. The company is the owner of the 26MW Glens of Foudland onshore windfarm near Huntly in Aberdeenshire, is developing a 72MW windfarm at Braes of Doune in Stirlingshire through a 50:50 joint venture with Airtricity, and has entered into long term power purchase agreements with a number of other renewable project developers, thereby allowing them to project finance their developments.

Centrica is a major offshore wind developer and our first Round 1 offshore windfarm, a 90MW development at Barrow is operating at full capacity. This is a 50/50 joint venture between Centrica and Danish energy group DONG, comprising 30 wind turbines. We are pursuing two additional

consented Round 1 developments at Inner Dowsing and Lynn, each of which have a planned capacity of 90MW. In addition, subject to consent and favourable financial returns, our three Round 2 windfarms in the Greater Wash will deliver a total of 1250MW of capacity.

Chapter 2 – Regulatory Options

Question 1

Which option do you favour and what are your reasons for doing so? Do you have any views on any aspect of our intended approach under each option?

Centrica's favoured option is Option 1 (a non-exclusive common tender approach). This option provides most flexibility and allows more than the existing TOs to be involved in the development of new offshore networks.

It also retains an element of competition in delivering the offshore infrastructure, which is essential if the objective is to minimise operating costs for offshore wind developers. If there is no competition, a situation could easily arise where the cost of the offshore network would be the same or even greater than under the present arrangement. This would be contrary to the aims of the proposed changes.

Furthermore, we believe a non-exclusive licensing option reduces the risk of no TO being appointed. It keeps open the potential to allow a developer to be appointed as its own TO in the event of no TO electing to tender for the offshore assets.

Question 2

Do you think that the approaches which have been ruled out should be considered further and are there any other options or approaches that should be considered?

Centrica are satisfied that the options have been considered in sufficient detail to allow Centrica to justify a preference for Option 1. The options have been consulted on previously and the industry (and interested parties) has been involved in discussions through OTEG and open OTEG meetings.

However, we think that elements of Option 3 ("Generator Tender" approach) should be considered further to enhance the overall efficiency and efficacy of the ultimate solution in ensuring value for money for our 6 million end-users and timely delivery of Government targets towards a 'low carbon economy'. (See Further Considerations, below).

Question 3

Should anything further have been taken into account in assessing the options?

Centrica are broadly satisfied that the two options being consulted are probably the best alternative solutions. It must be remembered that the government's renewables obligation has the objective of delivering up to 20% of the UK's electricity needs from renewable sources by 2010. This objective can only be met through a concerted programme of renewable build across all near-market technologies, the most important of which is offshore wind.

Chapter 3 – Practical Issues under the regulatory options

Question 1

Could providing anything further, beyond the comfort of already provided by Ofgem, be justified for projects that will be constructed or have secured financial close prior to the award of offshore TO licences?

Unfortunately Centrica are not completely convinced that Ofgem/DTI have fully addressed the two issues identified by the OTEG group, namely the “legal issue” and the “price issue”.

On the Legal Issue, we accept that the exemption regime will give a degree of comfort to developers of new and existing infrastructure prior to TO adoption.

On the Price Issue, we remain concerned that there is little clarity on how the adoption process will be undertaken. Particularly, we ask for further definition of ‘properly incurred and necessary for purpose’ and ‘efficient’ level of costs. We propose that an agreed framework be established to provide clarity on the “allowable” activities/costs that will be considered within the value calculation. We also believe that there needs to be broad agreement on the standards that new assets should be designed to. Although work in this area is being undertaken, there are currently no obligations on any party that they will abide by the outcomes of this group. Centrica believe there is still a high level of risk that an offshore TO who undertakes to adopt transmission assets, may require changes to be made to installed assets, increasing cost to all parties.

Question 2

Would departure from Ofgem’s current approach to the adoption of assets be justified or would different treatments be unduly discriminatory?

Centrica fully expects Ofgem to be consistent in its approach to adopting existing transmission assets. The adoption process and the detailed mechanics on “how” adoption will be implemented should be the subject of further consultation, but in the meantime, the transfer (i.e. sale) of assets from developers to TOs should be done on an equitable basis. We suggest an agreed framework on the process of adoption to ensure an equitable methodology across all schemes.

Question 3

What are your views on the potential costs of TOs of bidding to build, own and operate offshore assets? Do you have any views on how such costs might be minimised?

Tendering costs between TOs and developers could be managed/minimised through discussions and closer liaison between the TO and developer – the SO/TO will need to work more closely with developers than they do currently for onshore projects (although we acknowledge that this may change following the current consultations on Section 36 Consenting Guidelines and Planning Issues respectively).

The developer may have already undertaken work on activities that could be useful for the TOs – we do not see any justification in repeating activities such as EIAs with the costs being ultimately passed onto end-users. In addition, it is not always the case that survey works need to be completed prior to bidding – what needs to be understood by the TOs is what costs can/cannot be recovered through the price control. Costs could be further managed by having clear guidance on what information is necessary before the tender process is carried out. This should be agreed in consultation with the industry.

Additionally, we have concerns with the GBSO being required to undertake offshore surveys. This is outside the scope of their current licence requirements and functions. Centrica do not believe it is appropriate for the system operator to become an offshore survey company. This is a whole new business area so amendments to their incentive scheme would be necessary. These would be potentially complicated and difficult to monitor.

Question 4

Do you believe there is a risk of lack of co-ordination that is specific to the non-exclusive approach? If so, how serious a problem do you believe this is? To what extent could the suggested measures or any other measure mitigate such a risk?

Coordination may become an issue, but at this stage we would perceive a greater risk in no TO coming forward to bid at all. An exclusive arrangement would provide no competitive tension. This is a new and emerging industry with a limited number of projects and interested parties. Learning and experience gained now should help the process develop and revisions can be made to improve efficiency for future projects. At present there is little coordination as developers are working independently to a large degree. It could be argued that introducing multiple TOs will enhance coordination – particularly if there was a licence obligation for them to talk to one another.

Question 5

Is it appropriate to allow generators to bid to provide their own transmission services, in particular in light of any potential moves towards unbundling at an EU level?

Currently, as stated above, this is a new and emerging industry, and so there should be no barriers to generators becoming their own TO. One of our key concerns is that no TO will come forward so it is imperative that the developer has the ability to bid for providing their own transmission service if they are to guarantee that the project develops on time.

In addition, we cannot ignore the fact that onshore developers are allowed to bid for the provision of their own transmission service, so it would be discriminatory not to allow it offshore. If EU legislation changes this in the future then the relevant changes can be considered at that time.

With regards to the “unbundling” issue, then it must be remembered that the primary driver behind unbundling is to encourage sustainable competition in energy markets. Our support for the Non-Exclusive arrangements is on the basis that they promote competition also.

Question 6

How can confidence be built that the tender process can be run transparently and fairly and to what extent can the proposals outlined in this chapter ensure this?

Independence of the SO is an ongoing issue for the industry. However, it has been accepted that with appropriate licence obligations, the SO can act independently in the onshore environment, so it is difficult to see why it should not apply to the offshore market also. It must be noted however, that obtaining information regarding onshore connections can be difficult, time consuming and costly – information should be more transparent to deliver a level playing field for all concerned – generators and TOs alike. The suggested increased coordination and communication between TOs (Question 3 above) may address this.

Question 7

Is it appropriate to have certain defined re-openers in a fixed-price bidding system?

It is difficult to respond to this question prior to knowing the detail behind the proposed Price Control (PC) and what Ofgem will allow to be included within the PC. However, in general, a pre-defined set of criteria to allow for price re-openers may be appropriate in certain limited circumstances. Indeed, there may well be different criteria for what pricing elements may or may not be re-opened for adopted schemes versus new ones.

Question 8

How should the geographic extent of exclusive regional licence areas be defined? What is the appropriate balance between obliging exclusive offshore TOs to assume unknown levels of risk and the need for a wider geographic area to ensure a TO is available to connect generators? Is it appropriate to make available three offshore TO licences that cover the three strategic areas and to leave the remainder of the offshore area unlicensed until the need for new licensees arises?

Centrica does not support the introduction of Exclusive Licences, and the difficulties outlined in the question further support our preference for a non-exclusive arrangement. The multi-TO approach also goes some way in reducing “unknown” risks associated with the adoption of existing schemes.

Question 9

On what basis should the competition for offshore exclusive TO licences be run?

Notwithstanding our preference for non-exclusive arrangements, we believe that the basis for competition for exclusive TO licences should be limited to the bidding for existing schemes and not to unknown future projects. Credit worthiness should always be taken into account and relevant experience needs to be treated carefully. There are very few organisations that have experience of installing and operating offshore transmission lines and the offshore environment is very different to the onshore market. We would argue that experience of operating onshore networks should not be the only relevant qualification and that any organisation that specialises in offshore engineering could be considered as a potential TO.

Question 10

What is the value and feasibility of benchmarking exclusively licensed offshore TOs and in what way could this be facilitated if desirable?

If exclusive arrangements were to be adopted then benchmarking will be necessary. Lessons learnt in international offshore transmission schemes and UK onshore networks should be used as benchmarks to establish common standards. Also, in the early years, continual review may be required as experience gained will lead to higher standards being established.

Question 11

How can suitable incentives be placed on exclusive offshore TOs to ensure that assets are constructed and operated economically and efficiently? Is there an alternative to simply passing through costs which raise the charges paid by consumers and generators? Would it be suitable to use international benchmarks as a means of assessing economy and efficiency?

Clearly, if an appropriate level of competition is applied for each project, the need for regulatory intervention in ensuring the economic and efficient construction and operation is eliminated. This is one of the key reasons why Centrica favours the non-exclusive approach. Should Government and Ofgem decide to use the exclusive approach, benchmarking will be essential to ensure that the exclusive TO is offering value for money and not extracting inappropriate profits from the Renewables Obligation. However, we are concerned that there are insufficient equivalent operations that are available for government to benchmark against.

We would expect any proposals regarding the charging regime for the final arrangements (exclusive or non-exclusive) to be subject of further consultation with the industry and all interested parties.

Question 12

What arrangements would be appropriate for dealing with future build outside of exclusively licensed areas?

The adoption of non-exclusive arrangements eliminates this problem and effectively makes the offshore transmission arrangements future-proof. If the exclusive approach is adopted and new schemes are proposed for areas outside the licensed area, then either:

- The licensed area needs to be extended to include the new project but clearly this can only be achieved with the support of the existing TO, and a new connection that is midway between two areas could present a dispute, or
- New, non-exclusive arrangements could be introduced for the new project(s).

Question 13

How can generators be provided with timely, firm offers within reasonable timescales under the exclusive option?

An exclusive arrangement could enable the TO to drag their feet resulting in unnecessary obstacles to the rapid deployment of renewable schemes for the UK's fuel mix. A non-exclusive arrangement however eliminates this possibility.

The longer the delay in granting licences, the greater the requirement to understand how adoption will work. Onshore connection offers are subject to consent, and offshore offers should be too. The risk of the onshore offer is also covered by security provided by the developer. This should also be in place for offshore schemes. We are interested to know what other risks of providing an offer Ofgem and DTi are considering here?

Further considerations

With regards to our preferred Option 1 for non-exclusive arrangements for Offshore Transmission Licences, Centrica are concerned about the proposed role of the GBSO.

It is suggested that the GBSO will manage the process for identifying the preferred TO for any particular offshore project. We are concerned that the GBSO have a conflict of interest in being one of the bidders and simultaneously managing the tender process.

To this end, and as mentioned earlier, we suggest that elements of Option 3 should be considered in the design of the ultimate solution. We consider that the generator/developer should be given the right, but not the obligation, to be involved in the decision process when selecting the preferred TO bidder. At the very least, a report should be presented by the GBSO when arriving at its decisions for all parties involved to scrutinise. It is acknowledged that the lowest cost option is not always the optimum solution for such schemes – environmental considerations and issues around the timing of installation can take precedence and so this transparent process will allow all parties to be satisfied that due diligence has been followed. It will also allow confidence and trust to be built in the process.

I trust this is useful and satisfactory. If you have any questions regarding this response, please do not hesitate to contact me.

Yours sincerely,

Dewi ab Iorwerth
Centrica Energy