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Offshore electricity transmission – second scoping document

Dear Giles,

E.ON UK welcomes the opportunity to respond to this consultation. Whilst we are broadly supportive of the way forward set out by Ofgem in the scoping document, much of the detail remains to be developed in potentially challenging timescales. Ofgem has set very challenging timescales for the delivery of the enduring rules and there is concern that this will not be achieved. Sufficient time will also be required to manage the transition of existing developments in to the new regime. The tender timescales for appointing an OFTO will mean that by its nature a longer time frame will be required to complete the transition process.

E.ON UK looks forward to working with Ofgem/DTI to develop the detailed rules for the regime. Although we welcome Ofgem's commitment to engage with industry as openly and effectively as possible, with the demise of OTEG we are concerned that, aside from the communication sessions, it is not clear at this time how Ofgem intends to enlist the help and support of the industry.

We have the following more detailed comments with reference to the chapters in the consultation:

Chapter 2 - Overview of the competitive transmission process

- Para 2.8 – we accept the concept of prospective OFTOs providing security (at an appropriate stage) but note that clarity will be needed on whether this would ever be recovered.

- Para 2.9 – use of common data to support prospective OFTO's bid's to minimise overall costs seems sensible and appropriate. How such

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intellectual property is made available and transferred between parties, with appropriate confidentiality provisions, will need to be established.

- Para 2.15 – although the tender process will need to be complete, it will be difficult for an OFTO and the GBSO to provide the final firm connection offer without the Authority approving the price control revenue allowance for the OFTO. Awaiting regulatory approval should not provide a reason for delay to the anticipated completion date of the connection.

- Para 2.18 – the co-ordination window seems sensible, however offshore generators should not be disadvantaged from obtaining TEC when competing with onshore generators. The timescales between the initial indicative offer and the final firm offer should not result in an offshore generation project's completion date going back, owing to other onshore offers having been accepted during the OFTO tender and appointment process.

- Para 2.21 – we note the initial view on funding for the competitive tender process. Management of the process will need to be timely and efficient to minimise costs.

Chapter 3 - Connection application process

- Para 3.10 – one possible method of securing the cost of the ASW could be for the OFT/GBSO to require an indemnity from the offshore generator. This indemnity would fall away once the User Commitment arrangements commence when the final formal offer is accepted.

- We note that costs may be incurred by parties other than the GBSO in initial assessments (e.g. by 'host' DNOs) and that these will need to be recovered.

- Para 3.12 – The offshore generator should be obliged to accept the final formal offer once it is finalised and made. This is because the final offer may not be sufficient for the project to proceed. If the final offer is not accepted the aforementioned indemnity would apply to the ASW costs in putting the final offer together.

- Para 3.12 – it is not clear from this paragraph whether or not the OFTO is committing to a revenue stream before carrying out detailed surveys. This will need to be clarified and adjustment mechanisms developed as

appropriate.

Chapter 4 – Connection via distribution networks

- Para 4.1 - we are pleased that this potential impacts of this issue in terms of creating a new interface have been recognised.

- Para 4.7 -we broadly support Ofgem's preferred approach. In particular, we do not believe that the onshore DNO should have any liability for the OFTO's network operations or assets. We support the approach of an up-front payment by the GBSO of costs for any additional works. In some cases the GBSO may have to decide between a DNO connection or a TO connection, and procedures would need to be developed to ensure this happens transparently and represents best value for consumers.

- Either the OFTO or GBSO, or possibly both, are likely to need to become parties to the DCUSA (distribution connection and use of system agreement), with an appropriate agreement beneath this umbrella structure. This mirrors the arrangements for the IDNO (independent distribution network operators)/DNO interface.

Chapter 5 - Design of tender process

- Para 5.3 – we assume the use of the word "required" does not imply an obligation on a 'pool' of pre-qualified potential OFTO's to bid.

- Para 5.6 – we welcome Ofgem's recognition that the tender process needs to be timely and efficient to minimise cost and delay. The rules and criteria for the process are essential to understand the implications to projects.

- Para 5.8 – it is not clear from the process how environmental planning and consenting processes are factored in to the timescales. Some of this could form part of the ASW or be undertaken by a consultant on behalf of all bidding OFTO's until one is appointed. Given the tender process lead times, valuable consenting time could be lost if this in not progressed in parallel, which could result in avoidable delay to projects. It would be sensible to identify key activities which would be common to any bid and/or could create a bottleneck vs. those items of work which might be bid- specific and relate to an individual OFTO's risk appetite.

- Para 5.11 – where possible it may be beneficial to the efficiency of the process if standard templates could be prepared for certain aspects of a bid.

- Para 5.11 - further clarity is needed on when the financial commitment would be made as para 2.8 implies a payment at the start of the process, wheras 5.11 implies a payment by short-listed parties.

- Para 5.14 – we can see the potential advantages of creating a 'window' in terms of co-ordination, but some degree of flexibility should be preserved to allow for developers who may not be at a stage to commit fully, but wish to express an interest, to enter into any initial discussions with the GBSO. This might be helpful, for example, in informing prospective OFTOs of the commercial risks and potential rewards of providing incremental investment.

- Para 5.14 - another risk of the windowing approach is that it concentrates resource requirements for tender assessments into prescribed time periods. This may drive a greater reliance on outsourcing by potential OFTOs, leading to artificially high bid costs if these resources are scarce. It may therefore be more appropriate to consider how developers may be incentivised to co-ordinate expressions of interest rather than impose a fully regulated solution.

- Para 5.14 – Prospective OFTOs will need to know what data will be shared when expressions of interest are sought to enable them to make a rational decision on whether to bid. Depending on the work required, costs could be substantial and subject to uncertainty, so up-front clarity on the treatment of these costs will be needed to factor into a decision to bid.

- Para 5.17 – it should be noted that becoming an OFTO is not core to a generator's business activity. Desire to do this by generators for expediency of project development is likely to be low, particularly with potential future unbundling risk and business separation requirements.

<u>Chapter 6 – Design of regulatory regime</u>

- As a general point, we are pleased that Ofgem have recognised the need to create a balanced framework. We have some concerns about the ability of any party to reach a view on O&M costs over a prolonged (e.g. 25 year)

period. Consequently, we believe it will be important not only to include adjustment mechanisms but allow for some flexibility around potential for re-openers (as is the case in other regulated price controls). Without these the risk premium priced in by bidders may mean the advantages of a regulated framework are not fully captured.

- Para 6.5 – whilst we agree with the general aim, we would question whether it is realistic to expect to be able to create a framework that deals with every future eventuality. It may be more appropriate to create short term clarity now, and specify criteria for future change (e.g. preset triggers).

- Para 6.9 / 6.13 – recognition is needed of the potential for cost overruns during construction that are not just due to changes in cable length (e.g. weather, errors or omissions in seabed surveys not undertaken by the OFTO). There will be a need for a contractually agreed delivery date. However, given the potential uncertainties it is unclear that writing a date on the face of the licence would be proportionate regulation. Clear criteria will need to be established to determine "legitimate" – i.e. uncontrollable – slippage.

- Para 6.9 – the definition of assets will need to clearly identify which standards and codes will need to be complied with, and whether any deviation above minimum standards is expected.

- Para 6.9 - performance standards need to specify what "normal" conditions are to be assumed (e.g. weather conditions for repairs) and what counts as an "unplanned" interruption – e.g. damage by 3rd party. Work will be required to establish whether the unpredictability of sea conditions allows a single value (as opposed to say a range) to be specified.

- Para 6.11 – again work will be required to compare the cost of obliging OFTOs to cover construction risk e.g. with insurance against the cost of recovering efficiently incurred additional costs from GB transmission charges.

- Para 6.11 – once built, network losses will not change during the life of asset without significant capex being incurred. Hence, this is a design, not

an operational criterion. It would seem sensible to specify some general requirement for minimising through-life cost, possibly including carbon impact.

- Para 6.12 – it also needs to be noted that one of Ofgem's duties is to ensure licensees' businesses can be efficiently financed. It is possible that if the framework is too inflexible, an OFTO may suffer financial collapse.

- Para 6.13 – the scope and strength of adjustment mechanisms will be key in determining OFTOs' risk exposure. Consequently, there will be a need to ensure consistency between final performance criteria and the information provided during the bidding process. For example, for a prospective OFTO to choose to either strengthen a design or undertake more survey work, clarity on the strength of performance incentives or contractual obligations will be needed for them to make an efficient decision.

- Para 6.14 - OFTOs will need darity on the value placed on incremental capacity by Ofgem or the developer, so a decision can be made as to whether to allow for it in the design.

Chapter 7 – Interim arrangements

- Para 7.1 – as previously stated, sufficient time will be required in advance of commencement of the regime to implement the transitional arrangements for those existing projects constructed or in development.

- Para 7.3 – in principle these criteria seem appropriate. It is not entirely clear what the exact cut off date will be, is it the present 'active' October 2008 date or the 'live' date once confirmed?

- Para 7.4 – the response to the legal question is unsatisfactory; the offshore generator's ability to become an OFTO for project expediency in absence of any other party coming forward, the OFTO of last resort, puts this party in a position of distressed bidder as the activity is not core to its business.

- Para 7.7 – We do not support the proposed policy position. Allowance of 75% of the ex ante cost is unrealistic and introduces risk to projects proceeding. The 75% value is an arbitrary number that assumes that the

contract costs negotiated by projects in development is not the best contract price that could be obtained in the market. 100% of the ex ante value should be allowed where a project is at financial close and entered in to contracts. Where the final cost is greater than the ex ante contract price/cost, the difference in cost should be subject to an ex post efficiency review.

- Para 7.8 – it is noted that the precise payment terms of the reimbursement will need to be developed and agreed. There is potential here for the introduction of regulatory risk which could act as a significant deterrent to potential adopters, through a mismatch of performance obligations, the asset design and the imposed asset value.

- Para 7.9 & 7.10 – we broadly support the approach for assessing compliance with technical rules, although if OFTOs have the final liability for compliance, then this clearly places significant obligations on the developer in terms of information disclosure. Where a project is not yet at financial close, Ofgem assessment of a design would be welcome to ensure compliance in so far as possible prior to contracting and construction.

Chapter 8 – Charging, access and compensation

- We support Ofgem's proposals that the offshore regime should reflect the existing onshore regime. We support the view that where a lower standard of security applies compensation for loss of access will not apply. With respect to charging, we remain of the view that an offshore generator should not expect to pay more in lifetime transmission charges than had it continued to own, operate and maintain the assets itself.

- It may be helpful in terms of reducing delays to develop standard terms and conditions or contracts for compensation where the developer requests connections of a standard above the minimum specified by the relevant codes.

Chapter 9 – Technical rules

- We note Ofgem's intentions to consult on changes to the Grid Code and STC and, separately, the DTI's intention to consult on the specific changes required to the GB SQSS for offshore transmission.

Chapter 10 – Implementation issues

- We have no additional comments to make on this chapter at this time to those made at the introduction of our response.

Chapter 11 – Work programme and next steps

- We have no additional comments to make on this chapter at this time to those made at the introduction of our response.

We hope that you find our response helpful. We would be happy to discuss any aspect of our response with you further. If you would like to discuss any aspect of your proposals to develop the offshore transmission regime we would be happy to provide you with any feedback.

Yours sincerely

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