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20th July, 2007

Connecting the Islands of Scotland June 2007

Dear Bob,

We welcome the opportunity to respond to the matters raised in this open letter. This response reflects the views of RWE npower, the UK based business of RWE Trading GmbH and RWE npower renewables.

Ofgem confirmed in its Final Proposals¹ that it would undertake further development work on the potential for facilitating competition in providing large transmission links. This open letter sets out alternative regulatory approaches for connections between the Scottish Islands and the onshore transmission network. The options being considered are:

1. The status quo, where the existing regulatory framework would place an obligation on SHETL to offer a connection on request;
2. A licensed merchant approach; and
3. A licensed price control framework, with regulated revenue and competitive tender.

At this stage, Ofgem's preference is for Option 3, which is consistent with the approach to the regulation of offshore transmission assets, the detailed arrangements for which are currently under development. Ofgem argues that a competitive approach could potentially bring quicker delivery, drive down costs and encourage innovation. In our view, whilst these benefits are theoretically feasible, they are at this stage suppositions based upon an approach to transmission asset investment that is unproven. The approach introduces considerable additional complexity and it is unclear how these pseudo-regulated assets will interface with existing onshore networks and any consequent effects on charging arrangements and the incumbent licensee's price control.

¹ Transmission Price Control Review: Final Proposals 206/06 4 December 2006

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Our starting point would be that current onshore mechanisms should be used where possible unless there are demonstrable reasons why they are not applicable. We have yet to see a convincing argument that connecting the Scottish Islands presents technical or economic features that, a priori, means that they should not be built by SHETL through a price-controlled route. This approach would utilise existing mechanisms that are well understood and that already provide for the relevant licensee's allowed income to be incremented to fund network extensions.

We would note that:

- ❑ The tender arrangements being developed for offshore wind generation have confirmed that even with a co-ordinated approach, there is a significant delay between the initial connection application and final appointment of TO and during this period developers face uncertainty about who the TO will be and the detailed technical design of the final scheme;
- ❑ SHETL already faces Economic and Efficiency obligations under its Transmission Licence and these should provide an appropriate investment framework;
- ❑ The current price control arrangements have been developed in a manner that specifically recognises that future generation sources will be locationally and technologically diverse and should be flexible enough to deal with these connections;
- ❑ Allowing the incumbent TO to build the connections will allow them to produce connection offers based on a co-ordinated and efficient approach under its licence as well as meeting concerns about meeting technical and other performance standards

We believe that developing an approach based upon the existing arrangements will minimise regulatory uncertainty, reduce risk for participants and offer the potential for more timely connections and for these reasons we support Option 1. The regulatory regime must establish conditions that support or are expected to support developers' investment in generation assets and we believe that it is for Ofgem to demonstrate the benefits of the competitive approach to the provision of monopoly transmission infrastructure.

We hope these views are helpful and if you wish to discuss them further please contact me on 01793 893983.

Yours sincerely,

Charles Ruffell
Economic Regulation